

Building Sustainable Cities through Blended Capital: A Program of Study and Case Analysis on The Kresge Foundation's Social Investments Practice in Detroit

Prepared by pfc Social Impact Advisors

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social impact advisors
*creative solutions
for complex times*

Designed for Oxford Social Finance Programme

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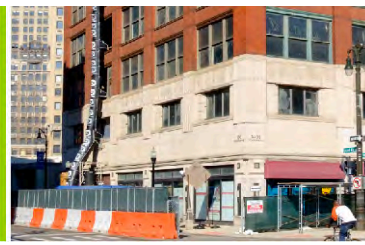
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Preface

Preface

The Kresge Foundation (Kresge or Foundation) case study, “Building Sustainable Cities through Blended Capital,” is part of a teaching series developed by pfc Social Impact Advisors to be used in the Oxford Social Finance Programme, Saïd Business School, University of Oxford. The case study will also be featured in the forthcoming Stanford University Press publication, *Good, Evil, Wicked: The Art, Science, and Business of Giving*. Both the book and series examine the strategies global leaders are using to tackle the world’s most complex problems. According to the World Economic Forum’s Global Risks 2017 report, the threats that keep world leaders across sectors awake at night include failing climate change strategies, poverty, weapons of mass destruction, mass involuntary migration, water crises, energy volatility, fiscal crises, and social instability.¹ This case study examines strategies to confront the interconnected web of complex issues facing cities and their residents as they address income inequality and reimagine a sustainable Detroit.



The Wicked Problems framework, first described by social scientists in the 1970s, offers leaders better tools to tackle these seemingly intractable issues.² Over four decades, much has been learned about what it takes to address the world's most difficult problems successfully.

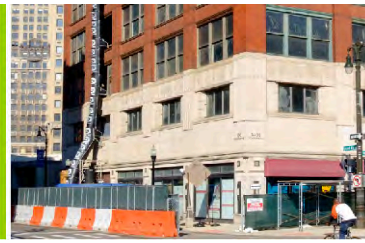
pfc has gathered these lessons together under the rubric of Deliberate Leadership, an amalgam of the most effective adaptive leadership strategies used in the business and social sectors that empowers leaders to deal effectively and thoughtfully with complexity.

The seven core characteristics (the 7Cs) of Deliberate Leaders are those that institutions, and individuals in those institutions, must consistently display to demonstrate flexibility and maximize learning:

- **Courage**—to embrace risk and live with the ambiguity. Deliberate Leaders recognize that simple solutions are insufficient to address complex challenges. They also realize that risk is inherent to Wicked Problems: solutions must be tried, tested, and allowed to evolve.
- **Collaboration**—to seek out and listen to divergent viewpoints. Deliberate Leaders recognize that building collaborative solutions may be slow and uncomfortable, but the process is essential to understanding options, gaining new knowledge, and building powerful solutions.
- **Community**—to build solutions together from the ground up. Deliberate Leaders recognize that answers to tough issues may already reside in Positive Deviants. They seek uncommon answers to difficult situations and put people at the center of decision making.
- **Candor**—to speak and hear the truth about what is working and what is not. Deliberate Leaders embrace failure and success equally—internally and among partners—to manage risk and allow for recalibration and innovation.
- **Creativity**—to imagine a new future and move beyond the constraints of the past. Deliberate Leaders look for “big ideas” and evolving practices through scenarios that envision a different future.
- **Capital**—to examine how financial and non-financial resources are invested and impact is analyzed.
- **Compassion**—to understand how empathy and partnership, not ego, impact the power dynamics within and surrounding an organization.

Each social challenge is, of course, a unique constellation of factors and circumstances. Leaders must, accordingly, be purposeful and thoughtful in choosing their approach. Should they command and control because they face a crisis? Can they manage the problem by calling on previous successful experiences? Do they face a challenge that requires them to be collaborative and adaptive leaders, adjusting their strategy based on a clear-eyed understanding of what is and what is not working? Can they hold to their vision while putting their preconceived notions aside, recognizing the strengths and limits of their expertise, and seeking solutions where one might least expect them to be, including within communities affected by the problem?

Deliberate Leaders, as explored in this series, are leaders who act with intention and recognize that they must accept not only the risks of the challenges ahead, but also the consequences of



their actions. If Wicked Problems were easy, they would have been solved already. With Wicked Problems, it is a given that there will be challenges, and that mistakes will be made. What is important is to learn, adapt, and move forward.

The series, as illustrated by this program of study, unites several case studies into one document to give readers a more comprehensive view of what it takes to tackle a complex problem through social finance tools, leadership and negotiation, policy intervention, equity, and alignment. The series also provides examples of Deliberate Leaders worldwide to offer a compass to other leaders as they take on the biggest challenges of the 21st century. These examples focus on those problems borne most heavily by poor children and families. The goal of the case study series is not to prescribe answers, but to stimulate discussion. Each case analysis poses questions to students and the broader field of social investing to help answer the question, “What would you do, given the circumstances?”

In this program of study, pfc follows the case study methodology developed by business schools to examine the perspectives of Kresge staff, board members, and local, national, and global impact investing experts as they recount their perceptions of the field’s and the Foundation’s successes, challenges, and lessons learned around their Social Investment Practice (SIP) in Detroit, Michigan and to Kresge’s overarching program goal of “Expanding Opportunities in America’s Cities.” Data for these analyses were drawn from Kresge Foundation materials and desk research, as well as from 27 interviews with staff and stakeholders (see Appendix 1).

Rip Rapson, president and CEO of Kresge, argues for the importance of seeing Detroit as emblematic of other post-industrial cities: “All too often Detroit is dismissed as *sui generis*. I would suggest that that is too easy a response—that in fact, it is a place with powerful lessons to impart to other cities across the globe. The particular challenges Detroit faces—education disparities, racial division, sub-optimal land use, economic polarization, and others—are manifest to varying degrees in cities well beyond the American rust belt. As we uncrack the code to these Wicked Problems in one place, we make it more likely we can do it elsewhere.”

This analysis yields insights into how Deliberate Leaders in a place like Detroit can and should embrace the seemingly soft considerations that can get in the way of positive impact: values and beliefs; organizational development and culture; accepting and celebrating risk and failure; alignment between funder and community; and, ultimately, deep recalibration based on knowledge and lessons learned.



Introduction

Introduction

In 2015, the United Nations (UN) created seventeen Sustainable Development Goals (SDGs) which, taken as a whole, are both a global blueprint and a universal call to action “to end poverty, protect the planet, and ensure that all people enjoy peace and prosperity” by 2030.³ To reach these goals, the annual investment is estimated at more than \$4 trillion. The current investment leaves a financing gap of about \$3.1 trillion, according to Marina Leytes, an impact consultant.⁴ “With official development assistance, so-called foreign aid, peaking at only \$135 billion in 2013, how do we meet this financing challenge?” she asks.⁵ According to Leytes, the financing possibility lies in tapping the global capital markets, with their funds of approximately \$218 trillion. When private, public, and philanthropic sectors bring their capital together to solve Wicked Problems, it is called “blended finance.”⁶

Richard Samans of the World Economic Forum (WEF) and Erik Solheim of the Organization for Economic Co-operation and Development (OECD) describe the solution in this way: “There is a



huge, and largely untapped, potential for public, philanthropic, and private actors to work together towards win-win-win solutions: wins for private investors, as they make an attractive return on their capital; wins for public and philanthropic providers, as they make their limited dollars go further; and most importantly, wins for people in developing countries as more funds are channeled to emerging and frontier markets, in the right way, to help transform economies, societies, and lives.”⁷

According to the private market, one of the biggest barriers to the flow of significant investment capital to solve big problems is that the rate of return, the time horizon for returns, and the level of risk are not proportional. Philanthropic capital can be used to mitigate risk and to stack capital necessary to unleash private investment—but how does that happen?

Drilling into the UN SDGs, Goal 11, Sustainable Cities and Communities, focuses on the planet’s urban areas, where over half of the world’s population now lives, and where two-thirds will live by 2050. “Sustainable development cannot be achieved without significantly transforming the way we build and manage our urban spaces,” according to the United Nations Development Programme (UNDP). To combat the extreme poverty found in the majority of the world’s cities will require “access to safe and affordable housing ... investment in public transport, creating green public spaces, and improving urban planning and management in a way that is both participatory and inclusive.”⁸

How will cities such as Hong Kong, Lusaka, or Detroit finance their efforts to rebuild and reinvent themselves to meet this audacious UNDP goal? Their pathways are as varied and different as the cities themselves. This case explores how one US-based philanthropic institution, The Kresge Foundation, has used its financial resources differently to address this global goal in its home state Michigan’s largest metropolitan area, Detroit. Why is Detroit relevant globally? Using SDGs as the analytical framework, the US Cities Sustainable Development Goals Index evaluated and ranked the country’s 100 most populous cities (measured as Metropolitan Statistical Areas, or MSAs) according to their level of sustainable development. Because of high levels of relative poverty, acute unemployment, and high emission rates, the Detroit-Warren-Dearborn region scored lowest on the Index.⁹

Context: Detroit as Comeback City

Detroit is not the only major US city to spiral from an urban economic powerhouse to a shell of its former success. Reliance on a single industry, widespread discrimination in housing and employment, and a shrinking population in search of less crime and better schools¹⁰ have contributed to the decline of many US cities in the last half century. Like many cities, Detroit faces a collection of Wicked Problems as defined by Horst W. J. Rittel and Melvin M. Webber, including widespread poverty, structural racism, instability in local government structures and institutions, and a global, national, and statewide recession.¹¹

In 2017, however, Detroit was dubbed “The Comeback City” by the news media, as well as by elected officials and corporate and community leaders. Living up to its motto: “We hope for better things; it shall rise from the ashes,” the city has emerged from the nadir of corruption and a 2013 municipal bankruptcy—the largest in US history—and decades of devastating population loss, with the city shrinking from its 1950s high of 1.8 million residents to just over 700,000 today.¹² Realtor.com ranked Detroit as fourth in its list of comeback cities,¹³ and the title of a



recent *Forbes* magazine article was “America’s Comeback City: The Rebirth of Detroit.”¹⁴ What all of these stories highlight is the remarkable decade-long transformation of the downtown and Midtown sections of Detroit, running along Woodward Avenue and comprising an area of just over 4.4 square miles in a city of 140 square miles.

The transformation of the downtown and Midtown, however, has not yet been enough to move the entire city out of decline.¹⁵

A study by Michigan-based academics concludes: “First, by a number of measures, Detroit continues to decline, and even when positive change has occurred, growth has been much less robust than many narratives would suggest. Second, the city recovery has been highly uneven, resulting in increasing inequality.”¹⁶

John Mogk, professor of law at Detroit’s Wayne State University, also sounds a note of caution, as he sees that Detroit’s decline continued for 60 years unabated. He believes it will take another 60 years to reverse that decline in all neighborhoods. According to Mogk, the comeback needed by Detroit is at “a scale beyond anything any other city has faced.”¹⁷

2017 also marks the 50th anniversary of Detroit’s 1967 civil unrest, also known as the Detroit Rebellion or the Detroit Riots. The massive civil unrest resulted in 43 deaths, hundreds of injuries, and over 7,000 arrests. Lasting five days and recognized as one of the largest civil disturbances in the US during the 20th century, the civil unrest has been widely characterized as a turning point for the city. According to the Detroit Historical Society, “White flight in 1967 doubled to over 40,000, and doubled again the next year. ... The city saw a massive growth in activism and community engagement. ... As the city’s demographics continued to shift, Detroiters elected the first black man in the city’s history, Coleman A. Young.”¹⁸

The racial inequality fault lines, brought into stark perspective in 1967, remain today. Sheila Cockrel, then a 20-year-old activist and more recently a city council member, said, “The irony is that today, working-class poor black people [in Detroit] are worse off than they were in 1967.”¹⁹

The *Financial Times* paints a vivid and sober picture of Detroit today, long after the civil unrest:

Half a century later, the neighborhood where Detroit’s 1967 riots began remains largely a wasteland. Where bakeries and bars once thrived on the crowded commercial thoroughfare of 12th Street, there is now nothing but vacant lots, a sad thrift store and a heavily fortified Chinese takeaway. Residential streets for blocks around are pitted with wood-and-brick cadavers of double-story homes where families once loved and quarreled.²⁰

This is today’s Detroit, where The Kresge Foundation was founded and where it continues to use every tool at its disposal to partner with residents to create a new future. Like many US-based philanthropic institutions, the Foundation began as the result of a successful businessman’s largesse.

The Kresge Foundation History

The Kresge Foundation is a \$3.5 billion private, US-based, national foundation that works to expand opportunities in America’s cities through grantmaking and social investing in arts and culture, education, environment, health and human services, and community development in Detroit.²¹



“Creating opportunity for low-income people is the hallmark of our work at The Kresge Foundation,” says Rapson. “Our programs seek to identify the inflection points where we think we can actually make a difference in the life trajectories of people who are poor, disadvantaged, or underserved in fundamental ways.”²²

The Foundation was established by Sebastian S. Kresge in 1924. With an initial gift of \$1.6 million, Kresge established a foundation bearing his family name in Detroit. He created the Foundation to commemorate the 25th anniversary of the S.S. Kresge Company, which began as a single five-and-dime store and grew into a national chain. Now the enterprise is known as the Kmart Corp and is part of the Sears department store chain. The family sold its interests in the business in the mid-1960s, redirecting part of the proceeds into The Kresge Foundation. The Kresge family remains involved on the board of the Foundation.

The Foundation’s founding purpose was broad: “The brilliance of Sebastian Kresge is best exhibited in his guiding wish that the Foundation ‘promote human progress.’ It is the responsibility of the board and staff to interpret his maxim and to take the Foundation where it needs to go to be relevant in the 21st century. Redefining ourselves as a strategic philanthropy represents our efforts to fulfill this responsibility,” says Elaine Rosen, chair of Kresge’s board.²³

For the first 75 years of its existence, the Foundation sought to strengthen nonprofit organizations by supporting the construction or renovation of their facilities—whether a hospital wing, a museum, an aquarium, or a college science lab. Over time, and in recognition that facility projects require significant capital, the idea of issuing capital challenge grants emerged as the Foundation’s central grantmaking tool—Kresge would match individual donations to a certain dollar level, providing deadline-driven incentives to complete a building project by enlisting a broad-base of individual donors.

As the challenge grant program grew in size, its rationale shifted slightly—imperceptibly to the outside—from “building buildings” to “enhancing the capacity” of nonprofits to harness what Kresge viewed as the transformational opportunity created by a large campaign to raise private funds from individuals.

Kresge became the *Good Housekeeping* Seal of Approval for capital campaigns. For many organizations, surviving Kresge’s demanding and rigorous application and approval process imparted a credential: stamping an organization’s approach as a model of effective fundraising. The Foundation’s brand was clear, its algorithmic method for calculating sufficient donor support was readily understood, and its sophistication about capital deployment was unparalleled in philanthropy.

The cumulative impact of the Kresge capital challenge grant model was unquestionably beneficial. It helped thousands of campaigns reach the finish line. It repeatedly provided an incentive that produced new gifts, larger gifts, and more engaged trustees and executives. It prompted organizations to set new benchmarks against which they could measure their development.

By the time Rapson was hired as Kresge’s third president in 2006, however, it was clear to the Kresge board that the Foundation’s traditional objectives and ways of working needed to be re-assessed and perhaps refreshed. The new president made the case to the board that it was time to make a pivot away from having only a single tool to address social challenges—capital



challenge grants—and toward deploying a more expansive toolbox against a broader suite of nonprofit needs.

Rapson argued that the fundraising environment of the late 20th century had fundamentally changed. Nonprofits had become increasingly more sophisticated in their approach to fundraising. An entire professional field of institutional advancement had emerged. Donors were better informed. The variety of capital available to support facility and equipment had expanded exponentially to include a range of public funding, debt financing, and charitable giving options.

Rapson suggested that although a building campaign was unquestionably a teachable moment in an organization's history, it taught largely in one dimension of a nonprofit's resilience and precious little about other aspects of its organizational capacity—the relevance of its mission, the efficacy of its strategies, the adaptability of its staff to changes in the external environment, the efficiency of its operations, the quality of its governance, and the like.

The board and Rapson then began a three-year process of determining what aspects of Kresge's past work continued to have value and should be carried forward, and what aspects no longer served the Foundation so well and should be discarded. Although Kresge retained its expertise at looking at nonprofit capitalization, it increasingly focused on providing a variety of types of grant support within the six disciplines that constitute its current programming: arts and culture, education, environment, health, human services, and community development in Detroit. In 2008, it launched a Social Investments Practice (SIP), and in 2011, it adopted what Rapson calls the "Urban Opportunity Framework," in which all six program areas are aligned with the overarching objective of advancing opportunities for low-income people living in US cities.

Annual programming funds are drawn from the interest earned on the \$3.5 billion endowment fund. The focus of this case is the Foundation's Social Investment Practice.

Social Investment Practice

The question that launched the Foundation's Social Investment Practice was a simple one. Rapson asked, "How do you make the capital spectrum work [for social change]?"²⁴ Rather than relying on a single form of capital, the board was asked to consider forms of capital the Foundation could use to achieve its mission.

Social investing was a way to leverage the Foundation's assets beyond traditional grants and to support markets not well served by the private financial sector. That meant providing capital to borrowers doing business in economically-stressed communities—where the risks were above average—or to buffer the economic risk of borrowers piloting new financing structures.

The two-fold mission of SIP is "to change people's lives for the better today and to influence the capital markets to more effectively serve under-resourced communities in the future."²⁵ According to the Foundation's website, "A lack of capital prevents many in our nation's cities from having access to necessities like quality child care centers, health clinics, affordable housing, healthy food, and social service providers, all of which stabilize, revitalize, and grow low-wealth communities."

"In most cases, grants alone aren't sufficient to solve today's most intractable issues," says Kimberlee Cornett, Kresge's managing director of SIP. She contends, "To get closer to expanding opportunity for people with low-incomes, we must use every tool and think



strategically about which best suits the problem at hand.” By bringing both Kresge funds and other investors to the project, the SIP seeks out the appropriate capital solution. Kresge’s capital tools include program-related investments (PRIs), which include debt, equity investments, and deposits’ non-cash guarantees; and market-rate, mission-related investments (MRIs), which are funded from the endowment. The Foundation made its first social investment in 2008, and has increased its commitment to approximately 10 percent of assets. In 2015, Kresge’s board approved a \$350 million pool for social investments to be deployed by 2020, while leveraging \$1 billion from other investors. Figure 1 describes the Foundation’s 2020 goal, by area of focus.

“To achieve its most ambitious goals, philanthropy simply cannot ignore the prospect of what is possible when multiple forms of capital are put to work,” says Rapson. “As our social investment portfolio has grown, we have expanded our team and the resources dedicated to this work, because we believe this all-in capital approach is essential to achieve our mission.”

The Foundation has four strategic approaches to invest the \$350 million commitment:

- Investments aligned with Kresge’s six programs, as well as investments structured to break through capital barriers to advance program priorities.
- Investments in mixed-income housing and mixed-use development.
- MRIs, which are market-rate, mission-aligned investments from the Foundation’s \$3.5 billion corpus.
- Increasing capital for communities working on challenges aligned with the Foundation’s program priorities through investments in Community Development Finance Institutions and Development Finance Agencies.



Figure 1. Kresge's \$350 Million Commitment to its Social Investment Practice²⁶



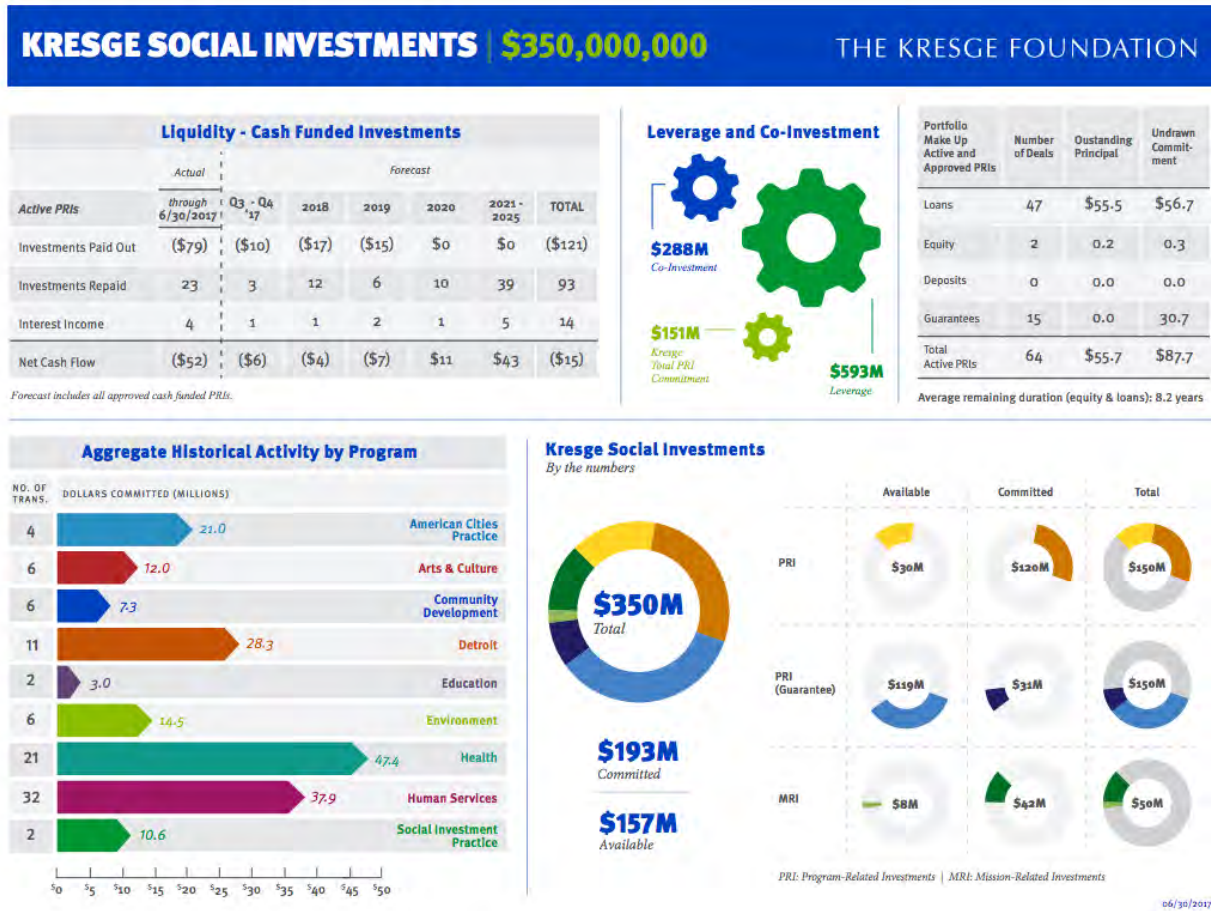
From 2012 to 2014, 26 transactions were approved and closed with all six program teams—some \$39 million in capital was deployed. Roughly \$16.5 million in loan repayments and interest were received back from organizations.

In 2016, the Social Investment Practice made 14 commitments totaling \$48.6 million, including six transactions through the Kresge Community Finance Initiative (KCF). These transactions leveraged more than \$227 million from other investors. Partners included many of the nation's largest banks, including JPMorgan Chase, Goldman Sachs, PNC, and Morgan Stanley, as well as other national funders such as the Ford Foundation, the Robert Wood Johnson Foundation, and the MacArthur Foundation. In a report to their trustees in 2015, SIP staff reported that the Foundation was among the top ten social investors in the philanthropic sector.²⁷

Introduction



Figure 2. Snapshot of the SIP Portfolio²⁸





Lessons in Deliberate Leadership

Deliberate Leadership is an adaptive leadership strategy that recognizes leaders who embody seven specific capacities to deal with Wicked Problems effectively and thoughtfully. The seven core characteristics (the 7Cs) consistently appear in the practice of this type of leader. Additionally, these leaders iterate through the Deliberate Leader Learning Process as they confront both challenges and opportunities by going through several stages of planning, action, and refinement.

Figure 3. The Deliberate Leader Learning Process



Using the Wicked Problem and Deliberate Leadership frames, the following five vignettes examine how The Kresge Foundation developed its Social Investment Practice, what risks were entailed, the role of community and equity, the creation of alignment, and examples of early impact.



Vignette 1: Launching through Leadership: Evolution of Social Investment Capital. This vignette starts with the leadership required to launch the new practice using the framework of Deliberate Leadership. What are the challenges and opportunities found at a point in time to create an innovative change strategy? Does leadership adapt to the new situation?

Vignette 2: The Dimensions of Risk: Weighing Tolerance for Financial, Impact, and Other Risks. Understanding the multiple dimensions of risks in impact investing presents both a challenge to the field generally and to The Kresge Foundation specifically. This vignette charts the Foundation's journey in understanding the many types of risk involved as it builds its social investing practice. What are the different types of risk that lead to enhanced returns?

Vignette 3: Embracing Diversity, Community, and Collaboration. This vignette looks at how equity and privilege play into change-making using social investing tools. In a multicultural world, how do you build a change strategy that benefits the most disadvantaged?

Vignette 4: Creating Alignment and Cultural Readiness for a Social Investment Practice. Introducing a new form of capital into a foundation's ecosystem causes ripple effects. This vignette unpacks how the microcultures within Kresge were both threatened and strengthened by the introduction of a new tool for mission impact. How does organizational culture adapt to new strategies to improve the work?

Vignette 5: Structuring a Blended Capital Deal: The Woodward Corridor and Leveraging Commercial Capital. This vignette traces one of The Kresge Foundation's biggest social capital success stories, the revitalization of the Woodward Corridor. It is intended to show how the Foundation leveraged capital to reinvest in Detroit to stop a downward spiral by expanding the tax base and generating new investment capital to revitalize and reimagine a new Detroit.

Questions for the Field

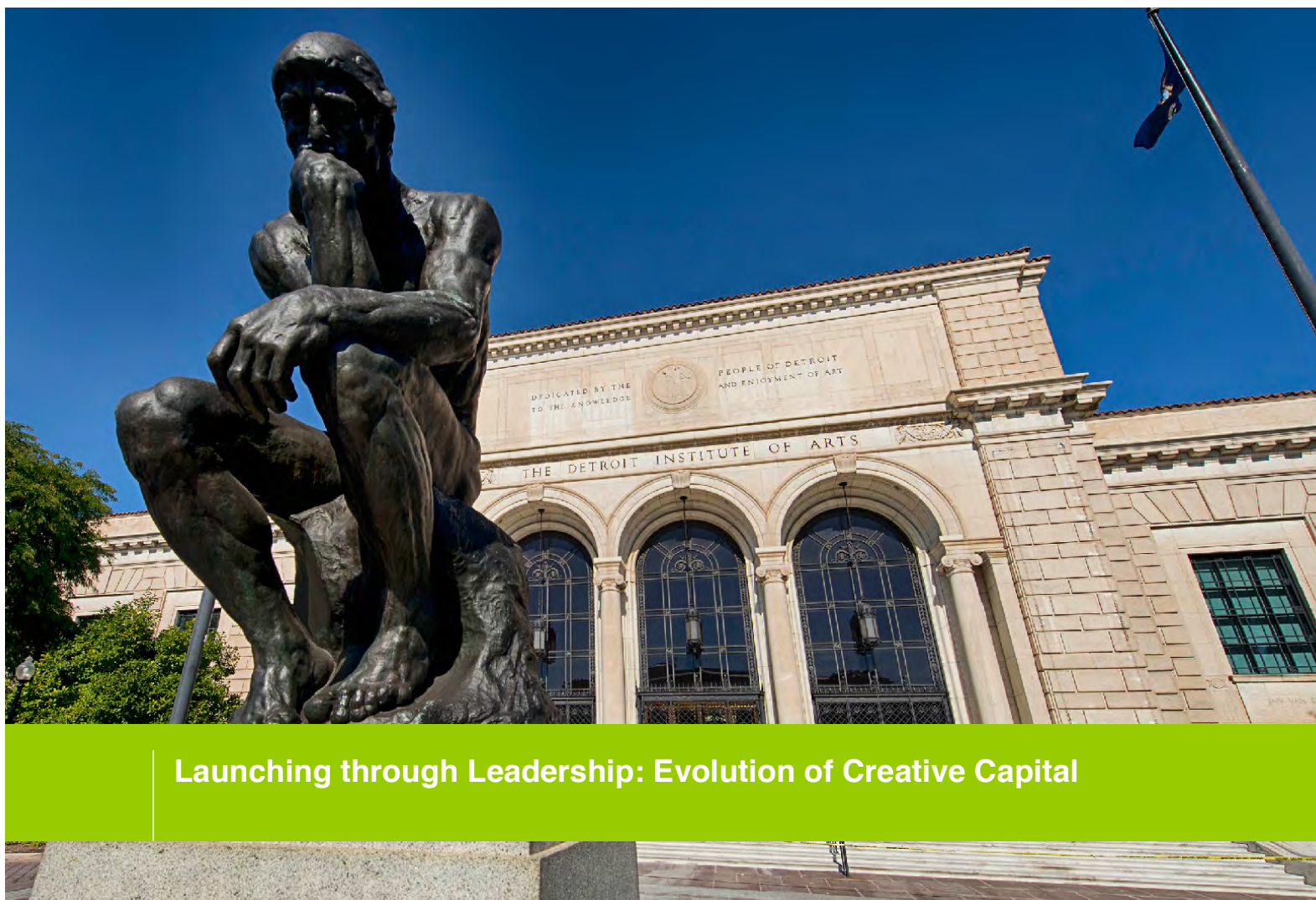
Whether looking at funders, grantees, or other stakeholders, addressing Wicked Problems requires a significant cultural shift for many organizations. The case's vignettes provide an opportunity to apply the tenets of Deliberate Leadership. The questions this raises offer students of philanthropy and social investors rich opportunities to discuss, debate, and learn in situations where there is no one correct answer.

- 1. Courage:** Based on your experiences and knowledge, do most funders diagnose complex issues properly? Do they support high-risk projects and solutions?
- 2. Collaboration:** Do they seek out divergent points of view and ensure that they are welcomed and protected at the table?
- 3. Community:** Can you think of illustrations of Positive Deviants and ways funders have worked effectively in-country to build a trusting relationship with communities? Have these organizations also built effective teams internally?
- 4. Candor:** How do funders create a culture that embraces openness and failure? How do they create a learning organization that reflects on its values, culture, and strategies and that builds on lessons learned?



- 5. **Creativity:** How can funders build “what if” scenarios and anticipate risks early in their due diligence and impact investing process?
- 6. **Compassion:** When and how do funders exhibit humility and empathy in decision-making?
- 7. **Capital:** How can funders value the social and financial assets of its partners and staff?

This handful of questions gets at the heart of being a Deliberate Leader. The case study offers information and analysis that can help to raise important questions on leadership and learning for the global field of philanthropy and social investing.



Launching through Leadership: Evolution of Creative Capital

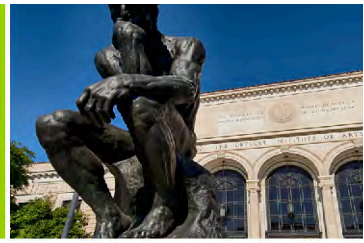
Vignette 1 — Launching Through Leadership: Evolution of Creative Capital

“Expanding opportunities in America’s cities through grants and social investments”

— The Kresge Foundation

2006-2008: The CEO, the Board, and Tiers and Baskets

In 2006, Rip Rapson became president and CEO, as the Foundation completed the first phase expansion of its headquarters to offices in in Troy, Michigan, with all of the attendant complexity of adjusting to an ambitiously green facility, novel technology, and unfamiliar offices. Rapson’s



arrival coincided with a global financial crisis that crippled the United States' and the world's economy, reduced Kresge's endowment by more than \$1 billion, and accelerated Detroit's decay. Rapson was a new leader, with different ideas, selected by the board at an inflection point in the Foundation's history to move from capital grants to more innovative grantmaking.

Against this significant backdrop of change and financial instability, Rapson began to rethink the Foundation's capital mobilization strategies. With the Foundation board's support, he helped design and launch what is now Kresge's \$350 million Social Investment Practice (SIP), and the words "and social investments" were added to Kresge's motto. Speaking a decade later about the build-out of SIP in front of a room full of leading impact investor foundations, Rapson underscored the importance of leadership in guiding grantmaking institutions into the realm of social investments. "The first precondition is leadership," he says. "The people at the top—your trustees, your financial team, and particularly your presidents and CEOs—need to embrace and articulate forcefully the case for using all the tools in the philanthropic toolbox."

Board chair Elaine Rosen offers her opinion of Rapson's leadership: "He just came in and quietly became a leader that everyone recognizes. He was, to be sure, armed with a \$3.5 billion endowment, but his way of working served to elevate partners and strengthen community."

Rapson and the Origins of Kresge's Social Investing Practice

Rapson came to Kresge as a veteran of urban policy and philanthropic leadership. He served as the deputy mayor of Minneapolis from 1989 to 1993 and was the primary architect of that city's Neighborhood Revitalization program, a 20-year, \$400 million effort to strengthen Minneapolis' neighborhoods. He also directed a comprehensive redesign of the municipal budgeting process and developed the mayor's initiatives to strengthen and support families and children.

He also served six years as president of the McKnight Foundation in Minneapolis, during which time McKnight was recognized as a national leader on a variety of public policy issues, including early childhood development, metropolitan growth, open space protection, and wind energy. At the McKnight Foundation, Rapson launched the Itasca Project, a private sector-led effort to develop a new regional agenda for the Twin Cities.

Rapson may have inherited his artistic gene from his father, as he is well-known for visualizing leadership and organizational strategies through drawings. For instance, Figure 4 below is known as his "Tiers and Baskets" drawing, and formed the seed of his vision for stretching Kresge's capital tools beyond capital challenge grants to include below market rate program-related investments (PRIS) and market rate mission-related investments (MRIs). Developed in 2008, the drawing explains the three tiers that Rapson envisioned for Kresge:

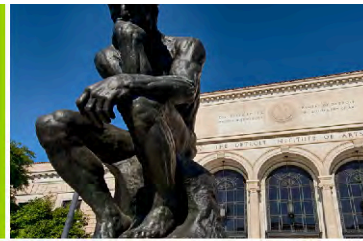
Tier 1: To stretch organizational capacity by stretching Kresge's capital tools.

Tier 2: To develop field-building strategies across six program areas—environment, health, arts and culture, education, human services, and Detroit. Tier 2 can be achieved by deploying the capital tools from Tier 1 in a manner that is values-based and context-based.

Tier 3: To develop Kresge's place-building strategies, through Tiers 1 and 2.

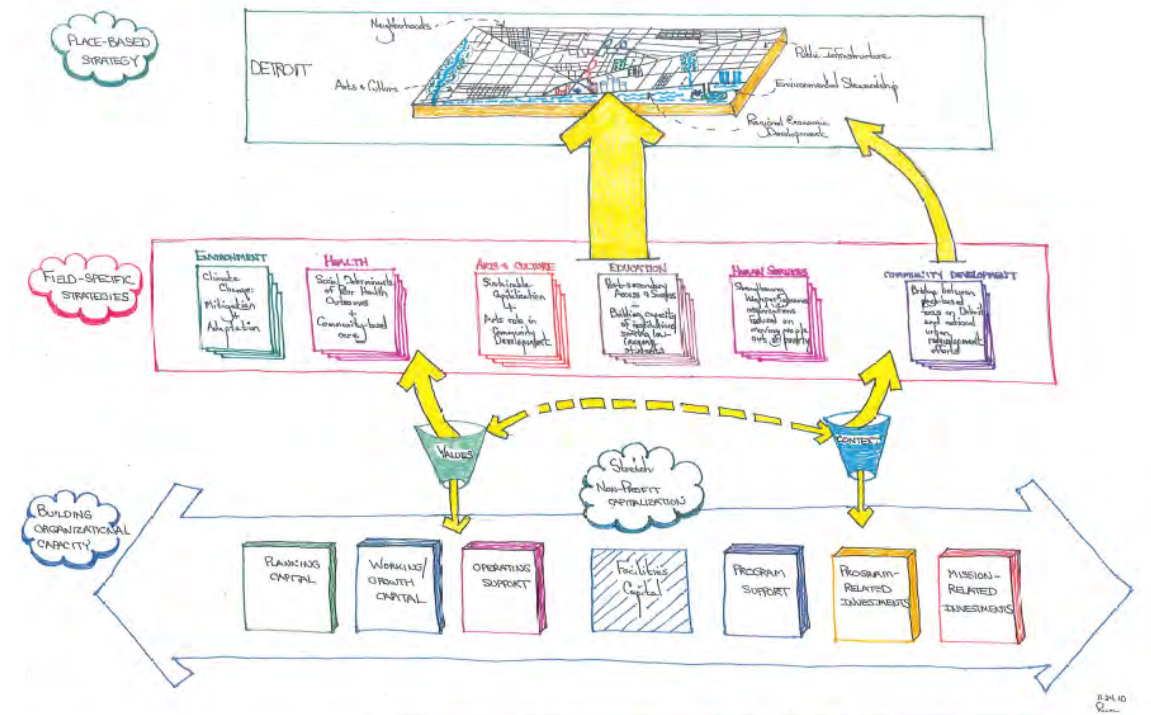
Describing his intentions, Rapson says, "When I came, I actually drew this tiers and baskets drawing for the board to emphasize that the first step in constructing a more strategic, impactful

Launching through Leadership: Evolution of Creative Capital



approach to philanthropy was to stretch the capital spectrum in ways that would involve deploying capital more flexibly.”

Figure 4. Tiers and Baskets²⁹



In another version of this diagram, he included a question below the spectrum of capital in Tier 1: “Should we authorize the staff to build out the ‘stretch’ and create a capitalization program?” (See Figure 5). This question is what set the wheels of Kresge’s social investment strategy in motion, and it required an answer from Kresge’s board.

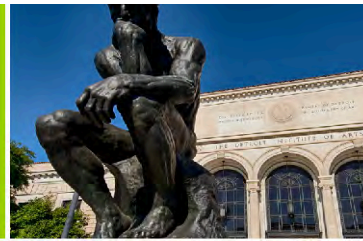
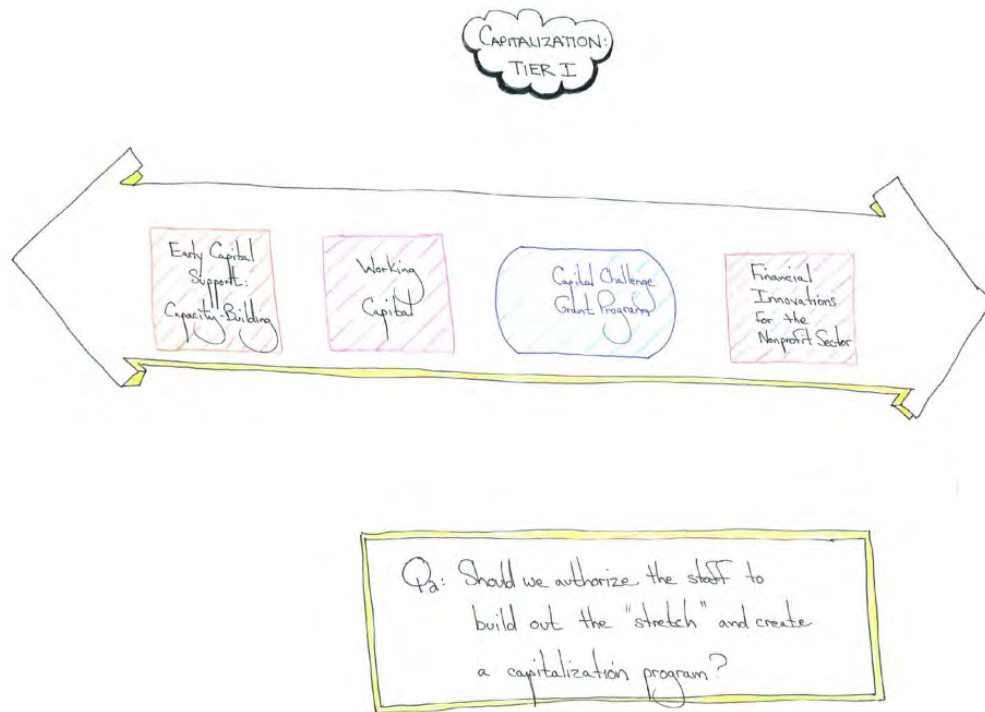


Figure 5. The Question as Drawn by Rapson³⁰



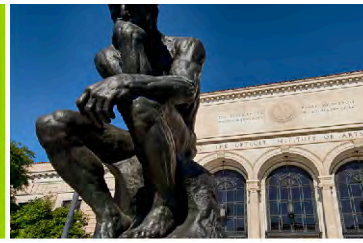
The Board

Rapson presented the diagram to the board and explained the process:

“... (what) we want to look at first is whether there are other forms of capital that are potentially beneficial to organizations. The whole point of this is that, at the end of that spectrum, on the right-hand side is innovative capital.”

Rapson was concerned that, unlike the capital challenge grant approach, in which the only value involved was fund-raising efficacy, in this new way of working, the values the Foundation hoped to advance would be paramount to decision making: “What other values are you trying to solve for ... innovation, community impact, equity, environmental sustainability? All of that aggregates up into place, and that's your third tier: bringing all of your organizational tools, all your field-building tools into a place, and that's Detroit.”

Working with Rapson, the board took the vision captured in the drawings and ran with the concept. Rapson credits one board member in particular—Jim Bildner—with propelling Kresge in the direction of PRIs and MRIs. “It was that last box on the capital stretch, the innovative capital box, that we didn't know what to do with until Jim said, ‘Why don't we experiment, try some things that are unfamiliar and untried? Why don't we try to see what that would really look like?’ Even with our past focus on capital challenge grants (the box in the middle), we readily understood operating capital and working capital and planning capital. But what we didn't quite



understand was whether there was something genuinely innovative at the far right end of the capital spectrum."

Bildner had joined the Kresge board in 2005 and had both academic and philanthropic credentials in social finance.³¹

Rosen says that part of what was attractive about this proposition was the idea that mission-focused money could come back and help preserve the Foundation's endowment during the difficulties of the global recession. "We had come through the financial crisis. \$3.5 billion is a lot of money, but it's not enough ... to save the entire world, and if we're not careful, it won't last forever..." Rosen says. She notes that the board discussed their founder's intent to create a foundation in perpetuity, and that led them to discuss how impact investing was capital that could be re-used, unlike traditional grants.

Rapson adds, "Jim Bildner urged us to pilot PRIs by making a series of modest loans to nonprofits dependent on government reimbursements to help them bridge to the other side of the recession. That some of them worked and some of them didn't was less important than the intellectual and political bush-whacking this represented. He cleared a path of safe passage for the staff. And our senior staff did, in fact, take that path—our CFO Amy Robinson, our CIO Rob Manilla, and our vice president of Programs Ari Simon, each got on the bus and proceeded to convince their team members that they needed to, as well. It was exemplary executive leadership."

2009-2014: Kimberlee Cornett and Programmatic Alignment

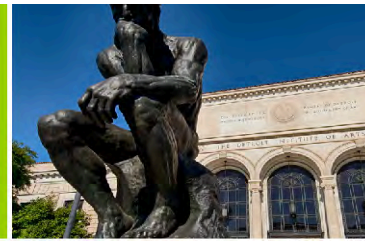
Rosen identified two major milestones during the period between 2009-2014. The first was the hiring of Kimberlee Cornett in 2010 to lead SIP and build-out the SIP team. The second was an affirmation that social investments must be aligned with programmatic objectives.

Before those two milestones, in 2009, the board passed what was then called the Strategic Investment Policy Statement (IPS). Its stated objectives were to:

1. Preserve the Foundation's endowment by revolving capital deployment to nonprofits.
2. Provide financing to organizations under terms and/or structures not available in the marketplace or that are needed to make a transaction viable.
3. Finance organizations central to the strategy of a Program Area.
4. Invest a portion of the Foundation's resources in vehicles that align the mission of the organization with the return objectives stated in the IPS.

As director of what was termed early in the process as Innovative Capital, Cornett was given a clean slate to be as innovative about capital deployment as she liked. However, she did not anticipate the resistance from grantmaking teams that were unfamiliar with and skeptical about the new investment strategy. For Cornett, seasoned in the capital markets, grantmaking was not a familiar tool. Similarly, for the program team, finance was a new world.

Until 2011, Cornett was a one-woman team, launching deal-making to develop credibility for the SIP. She soon came up against operational roadblocks. She tells a story of handling a New Markets Tax Credit transaction, which had a very clear requirement that the deal had to close



on a specific day. “We needed to fund at closing, only to discover that the Foundation only cuts checks on the 15th and 30th [of every month]. This was an operational system that was appropriate for grantmaking, but not well-suited to investment,” she says.

Some of these concerns were addressed when the team was expanded to include SIP deputy director Kim Dempsey, portfolio manager Joe Evans, and social investment officer Aaron Seybert. These additions would help build relationships across teams and help modify operational practices.

During Cornett’s first five years and after the expansion of her team, the organization followed a steep learning curve about when social investment tools would be deployed, what kinds of objectives would be pursued, and what internal machinery would be utilized. It was an exercise similar to designing a plane in mid-flight. Deals such as the \$30.25 million Woodward Corridor Investment Fund were being closed at the very same time the organization was addressing operational and cultural pain points.

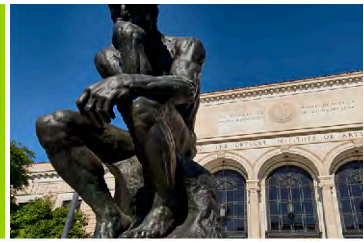
To address tensions between the program teams, the SIP team, and the Investments Office, Foundation leadership was helping staff work through challenges, such as the idea of the programmatic bull’s-eye—i.e., every social and mission investment had to fall within the specific program objectives developed by different program teams. Rapson also developed two frameworks to categorize the objectives of programs as “*What We Do*” and the different modes of capital—grants, loans, guarantees, equity—as “*How We Do It*.” According to vice president and chief program and strategy officer Ari Simon, this latter framework was helpful in promoting internal cultural alignment and to communicating Kresge’s work externally.

2015 and Beyond: \$350 Million and Next Steps

The most significant milestone for Kresge’s SIP came in 2015, when the board allocated \$350 million to the PRIs and MRIs, to be deployed by 2020. To the SIP team, this was validation of the credibility they had built with the Program Teams and with the Board. At the time when the capital was sanctioned, social investing practices at other similarly-placed foundations were reviewed, and Kresge’s new commitment rated it a spot in the top ten. (Figure 6)

Figure 6. Foundation rankings in social investing³²

Foundation	Assets Under Management	Social Investment Portfolio/MRI Pool	Percentage
Gates	\$40 billion	\$1.5 billion	3.75%
Ford	\$11 billion	\$600 million	5.45%
Kellogg	\$8 billion	\$110 million	1.38%
Packard	\$6.5 billion	\$180 million	2.77%
MacArthur	\$6 billion	\$300 million	5.00%
Rockefeller	\$4 billion	\$38 million	0.95%
Kresge	\$3.5 billion	\$80 million	2.29%
Annie E. Casey	\$2.5 billion	\$100 million	4.00%
McKnight	\$2 billion	\$200 million	10.00%



Bildner compares the SIP to a start-up, one that began with a small team and flexible oversight at the board and CEO level. As the practice grew and developed proof points, the board decided, "... let's make this big-time. Let's dedicate \$350 million, and our real goal is to leverage that 10-1."³³ When asked what's next for SIP, Bildner responds, "It's not clear to me what now happens. It's entirely possible that the practice has grown as big as it should grow. Relative to Kresge's overall asset base, \$3.6 billion, plus or minus, \$350 million being recycled over time is about right," he says.

Whether that is the prevailing opinion on the board or staff remains to be seen. What is clear, however, is the role that adaptive and flexible leadership contributed to the development and growth of the Social Investing Practice at the Kresge Foundation.

Questions for Consideration

- How do adaptive leaders understand their current reality, see the future, and chart a new way forward?
- Given the level of crisis in Detroit and globally, were there other paths Rapson and the board could have chosen?
- What strategies are needed to build alliances and support among an organization's leadership, program staff, and board? How are these alliances maintained while navigating the Wicked Problems of poverty and racism, and the ability to reimagine a new city?

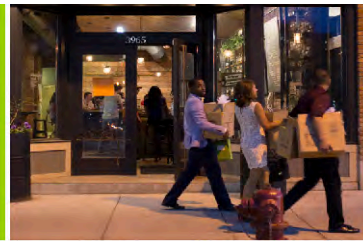


Weighing Tolerance for Financial, Impact, and Other Risks

Vignette 2—Weighing Tolerance for Financial, Impact, and Other Risks

“This period from 2008 to the bankruptcy is one of the most interesting periods in philanthropic history because ... it presented risk that was so multi-dimensional and that was of such an enormous magnitude. It is not an overstatement to say that the future of the city hung in the balance. We had to take this risk on and calibrate our responses just right. If we had not done what we had done, it's unimaginable where we would be right now.”

—Rip Rapson, president and CEO, The Kresge Foundation



Introduction

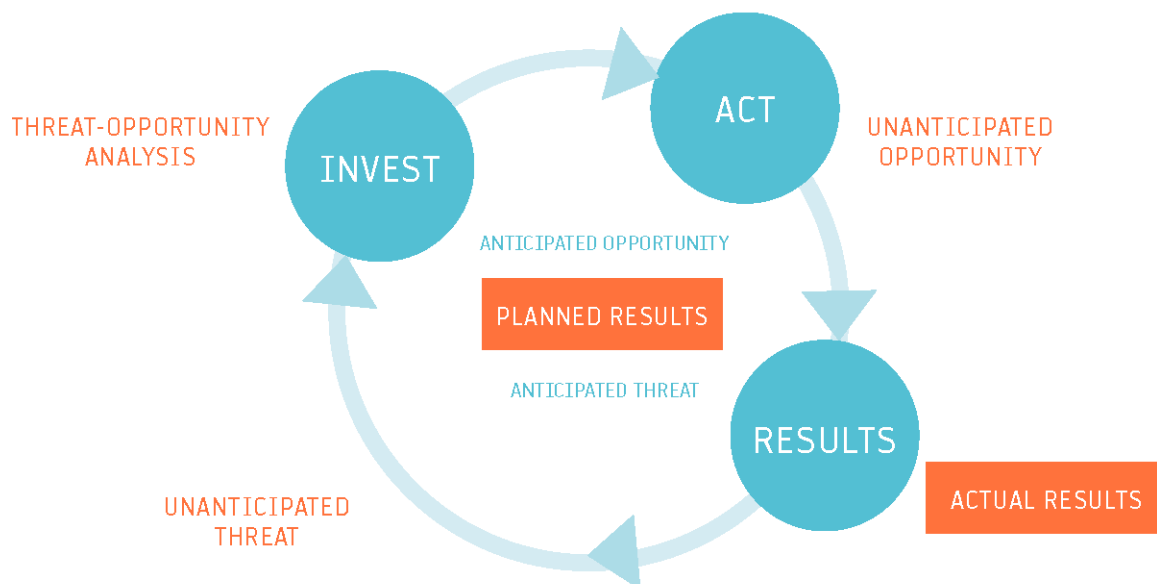
When the United Nations Development Programme (UNDP) examines risk to the realization of its organizational goals, it examines the external and internal influencing factors that create uncertainty. UNDP utilizes an Enterprise Risk Management (ERM) System to manage the risk.

The system seeks to:

- Identify and treat risk throughout the organization;
- Identify opportunities and threats;
- Encourage proactive management and better informed strategic decision taking; and
- Effectively allocate and use resources for risk treatment.³⁴

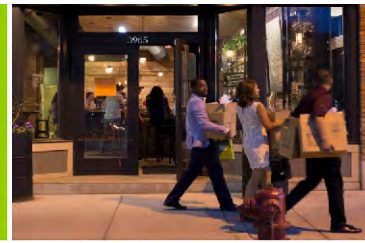
Figure 7 (below) visualizes the relationships inherent in a threat-opportunity analysis that leads to improved strategic decisions and results.

Figure 7. Threat-Opportunity Analysis



With this framework in mind, a variety of risks are inherent in social finance, which seeks to create measurable social benefits alongside a financial return. Social investing provides an option for financing social impact through a blended return, and the overall return is achieved by combining an investment's social impact with the financial return.³⁵

Every investment of this type creates at least two different kinds of risks: financial and impact. As the field has matured, the risk conversation has moved beyond a choice between impact first or financial return first. This trade-off is no longer the best lens to use when evaluating the risk associated with an investment. A much more nuanced view is now required, one that places the investment in a spectrum across a portfolio with various levels of risk, return, and impact.³⁶



“In the same way, traditional investors cannot consider risk in the absence of return, impact investors must assess a trifecta of risk, return, and impact,” says Jed Emerson from ImpactAssets, a nonprofit connected to Calvert Foundation.³⁷

Different types of institutions have different levels of risk tolerance on both the impact desired and the financial return generated. When compared to traditional lenders, philanthropic investors can afford to shoulder additional financial risk, which is an important part of the capital stack in many impact investing deals. Matt Onek, CEO of the Mission Investors Exchange, describes the role of philanthropic pioneers in the social investing space: “When innovative foundations assume more risk so that other investors can assume less, they increase the capacity for impact.”³⁸

A tax-exempt US private foundation has at least three types of capital: direct grants that generate only impact; program-related investments (PRIs), which are below market loans and legally prohibited from generating market rate returns; and mission related investments (MRIs), which seek to generate market level returns. In the second two areas, foundations can step in as lenders without the pressure of having to maximize profit for their shareholders.

Debra Schwartz, managing director of impact investing at the MacArthur Foundation, puts it another way: “We own our assets. This means that we, almost alone in the impact investing ecosystem, can engage in really meaningful risk taking, paving the way for others to join in.”³⁹ The Urban Institute’s Kim Reuben agrees, “You recognize that part of what you’re doing is riskier, but part of it comes close to what your mandate in terms of doing good is, (and) it becomes easier or more possible to do that investment.”

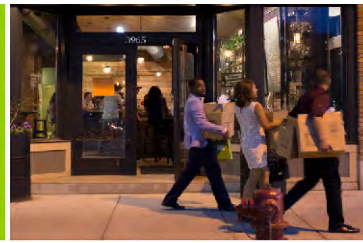
Typology of Risks

According to Bridges IMPACT+, the advisory arm of Bridges Ventures LLP, an impact investment fund group, “... interviews with a wide range of asset owners and advisors globally revealed certain shared concerns about the financial aspects of performance where impact investments, relative to other investment options, may fall short.” They propose ways to mitigate each kind of risk in their report, *Shifting the Lens: A De-Risking Toolkit for Impact Investment*.⁴⁰

Bridges identified five types of risk, including:

- **Capital Risk.** The risk of an asset owner losing any of the original investment amount, in either real or nominal terms.
- **Exit Risk.** Most impact investments are structured as debt or equity structures, where the path to exit or liquidate the investment is less certain.
- **Transaction Cost Risk.** Transaction costs (the time and money spent on due diligence, deal structuring, and ongoing monitoring of the asset). The smaller the transaction, the greater the risk that these costs will be out of proportion with potential returns and therefore prohibit investment.
- **Unquantifiable Risk.** While all investments carry risk, unquantifiable risk applies to situations in which the world is not well-charted.
- **Impact Risk.** The possibility that the investment will not have the hoped-for social impact.

Weighing Tolerance for Financial, Impact, and Other Risks



According to Emerson, there are additional types of risks for investors. These include:

- **Manager Risk.** Shorter track records in the impact space, with smaller asset bases and portfolio breadth, along with less robust compensation models that may lead to turnover of staffing.
- **Fund Development Risk.** Due to various constraints of the impact segment for raising and investing capital, investors must also be able to assess any given manager's ability to close a fund at scale and not get caught in stalled funds or invest in funds that are unable to—or are too slow in—deploying the capital in suitable impact investments.
- **Measurement and Reporting Risk.** Given the challenges and difficulties in measuring social and environmental impact, investors seeking to maximize impact, as opposed to only financial returns, may be exposed to inaccurate assessment of social and environmental impact.
- **Social Enterprise Risk.** This type of risk shares much in common with traditional enterprise risk, but is viewed through the lens of the venture's social commitments and orientation.
- **Subordinate Capital Risk.** Reliance on grants or other subsidies, such as subordinate investments from concessionary funders, and whether that added complexity is likely to yield either better results or perhaps fail to materialize at necessary levels, therefore impairing the outcomes of any given investment strategy.⁴¹

Guiding Principles for Identifying and Treating Risk

Overall, three principles can guide impact investors: what kind of impact is desired, how deep or broad is the intended impact, and what level of risk can be tolerated?⁴² A recent survey of impact investors by the Global Impact Investing Network (GIIN) found that “unsophisticated measurement practice is one of the five biggest constraints to growing the impact investing market.”⁴³

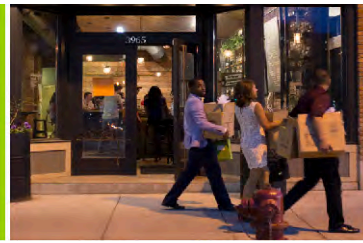
As Antony Bugg-Levine, CEO of the Nonprofit Finance Fund, Bruce Kogut, a professor at Columbia Business School, and Nalin Kulatilaka, a professor of Management at Boston University, argue in the *Harvard Business Review*: “In many areas, the market machinery and infrastructure for evaluating social risks and returns are barely developed. This can have two effects: It can starve good organizations of funding and leave investors focused solely on financial returns.”⁴⁴

According to Cornett, Kresge may not be doing as good a job as it can in evaluating both kinds of returns. “We're not doing it very well ... I think it's complicated with our work, because you can assume that when money is moving and when money is coming back that that means you have achieved an impact. I do think that's one of the dangers for us and for others, in that you can use repayment as a proxy for success, and it's not necessarily true.”

Detroit Timeline

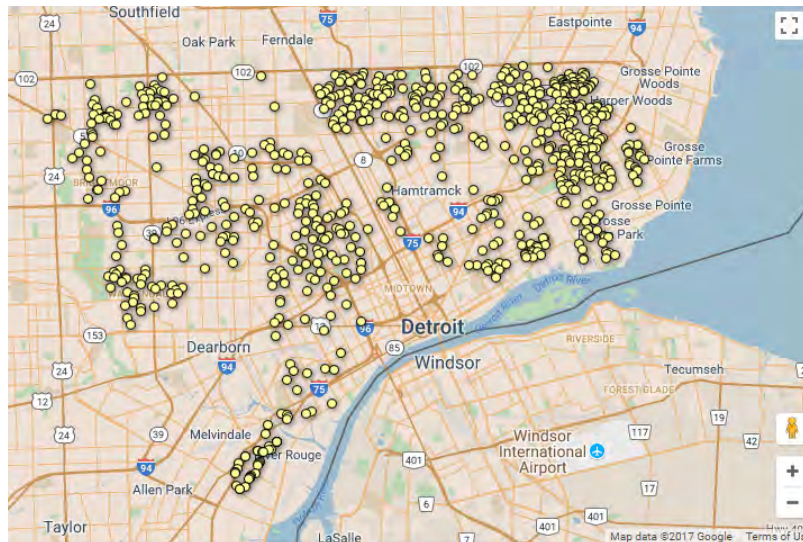
By 2007, Detroit was in the throes of an intensified version of America's housing and jobs crisis. The collapse of the housing bubble hit Detroiters particularly hard. Not only did the city see one of the highest rates of subprime lending at 68 percent of all 2005 mortgages (compared to the 24 percent national average),⁴⁵ but at the same time the State of Michigan also faced a drastic decline in auto manufacturing jobs (305,000 jobs lost between 2001-2005).⁴⁶ Homeowners who

Weighing Tolerance for Financial, Impact, and Other Risks



were drawn in by adjustable-rate mortgages with “low teaser rates” of two percent saw those rates spike to as high as 14 percent in subsequent years.⁴⁷ As a result, one-in-three Detroit properties have been foreclosed on since 2005, and 56 percent of the city’s mortgage foreclosures have since become blighted or abandoned.⁴⁸ Property prices plummeted 73 percent to \$22,000 on average—the lowest of any American city and one-ninth of the national average selling price. Figure 8 provides a snapshot of the extent of this real estate crisis.

Figure 8: Foreclosed Detroit Homes Selling for \$500⁴⁹



In 2010, the *New York Times* reported a devastating portrait of the city, “Anatomy of Detroit’s Decline:”

“About 36 percent of the city’s population is below the poverty level, and, by 2010, the residential vacancy rate was 27.8 percent. With fewer people paying taxes, the city has starved financially and has struggled to maintain social services. Swaths of the city are in total darkness because of nonfunctioning street lights. And the average police response time, including top priority calls, is 58 minutes, according to a report by the emergency manager.”⁵⁰

Then, in 2013, the city declared bankruptcy, the largest municipal bankruptcy in US history. It is against this drumbeat of decline that The Kresge Foundation began to look at the risks entailed in using its philanthropic capital in new ways.

Kresge’s Risk Appetite

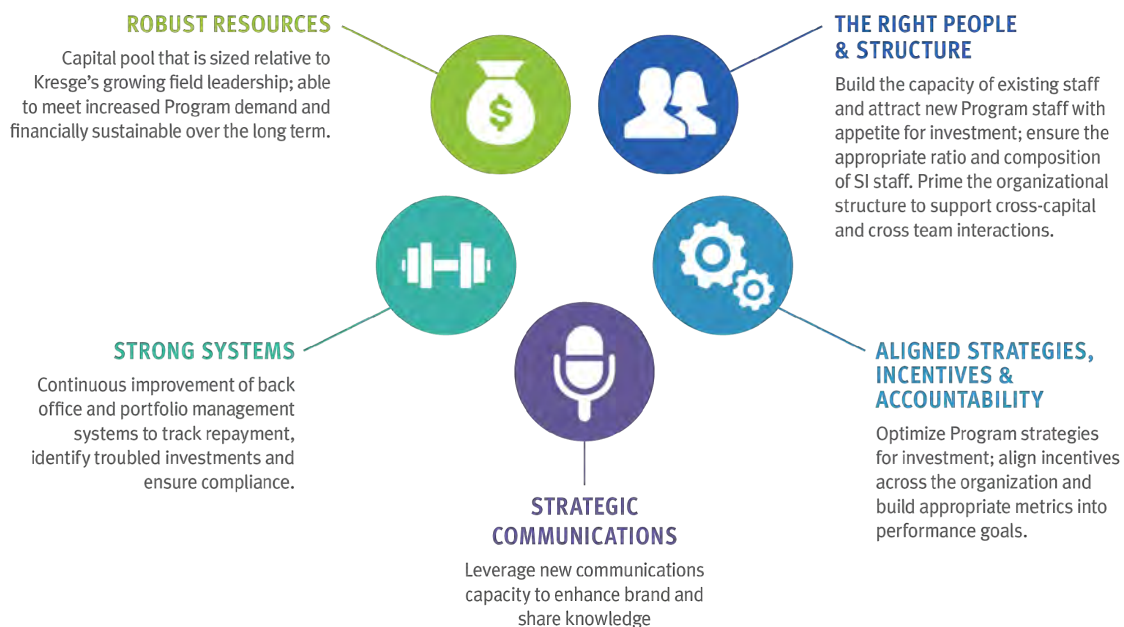
In 2008, the Kresge board began to grapple with what Rapson called “stretching their thinking about how to use the Foundation’s capital.” He challenged the board to “think about providing capital in forms that we haven’t yet identified that would be of help to different organizations in different circumstances.”

Weighing Tolerance for Financial, Impact, and Other Risks



According to trustee Jim Bildner, the composition of the board at that time was “uniquely functional,” and the economic downturn provided the impetus for new thinking. “We were presented with massive challenges for which social investment was the right answer,” he says.⁵¹ Figure 9 illustrates how various elements of capital, systems, strategic communications, staff, and strategies eventually came together to promote effective social investing at Kresge.

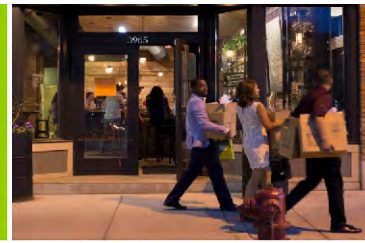
Figure 9. Elements of Social Investing⁵²



In 2009, the Kresge board adopted a formal statement on impact investing that outlined their risk tolerance “in non-grantmaking yet socially-oriented activities.” Their risk tolerance was spelled out as:

- **Sponsor Risk.** The failure or underperformance of an organization that affects the ability to repay a loan in full and/or on time.
- **Program/Project Risk.** The viability of a specific organization or transaction.
- **Contingent Risk.** A call on a standby obligation made by the Foundation.
- **Tax Considerations.** Participation in a structure deemed outside of IRS guidelines.⁵³

Another kind of risk was identified by Rapson: the risk of doing nothing. “This period from 2008 to the bankruptcy is one of the most interesting periods in philanthropic history because ... it presented risk that was so multi-dimensional and that was of such an enormous magnitude. It is not an overstatement to say that the future of the city hung in the balance. We had to take this risk on and calibrate our responses just right. If we had not done what we had done, it's unimaginable where we would be right now.”



Rapson asserts that how staff have talked with the trustees about risk has changed over time, and it has been central to every significant conversation. “The Foundation’s first loans were small and straightforward, intended to help key human service organizations survive during the recession. The risk assessment was correspondingly straightforward. There was very little moral risk, very little institutional equity risk,” Rapson notes. “As the deals emerging from Kimberlee’s growing social investment portfolio became more complex, the risks became more complex, and came to involve every piece of the organization. It became clear to both the staff and the Board that a social investment was not just a financial proposition but also a strategic proposition, a reputational proposition, and a legitimacy proposition,” says Rapson.⁵⁴

How Kresge Manages Risk at the Deal and Portfolio Level

Robert Manilla, Kresge’s chief investment officer, summed up the case for risk among the different kinds of capital flows: “I should probably be willing to take some pretty egregious risks with grants, and maybe a little bit less with something in the social investment world, and maybe a little less yet from a social perspective and MRI world. It’s just different stacks of a risk spectrum and not dumb or smart. It’s just what are you actually trying to accomplish with that [capital], and what forms of capital the market is asking for.”⁵⁵

According to Cornett, “At the deal level, we look for partners with an economic stake in the transaction, ensure that reserves or other safety net measures are present, seek guarantees from the partner or other parties when available and when possible, or share the risk with other investors.” She explains that at the portfolio level, they manage risk by: establishing loss reserves based on the risk ratings of each investment; monitoring the portfolio for concentrations relating to size, partner, duration, and asset type; and incorporating some safe bets to offset other risk.

Cornett contends the biggest way to mitigate risk to the Foundation is through good portfolio management. “Investing time and money in building strong portfolio management practices and systems is dry and unexciting, but, I believe, [is] the make-or-break element of risk management.”⁵⁶

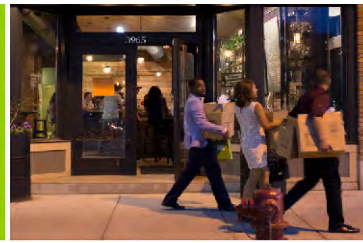
Aaron Seybert, SIP social investment officer, explains, “I think for philanthropy, in particular, we are striving very hard to push ourselves to be very clear on the risk that we’re taking.” The Foundation has grown in its understanding of the risks of impact investing as their practice has grown in the last ten years.

Kresge’s Evolving Risk Assessment

In 2012, when Kresge created the Woodward Corridor Investment Fund (WCIF), the Foundation examined risk in a very careful manner. Risk factors included:

- **Real Estate Market Risk.** The ability of the fund to recoup investments may change because of broad changes in the market or poor investment selection, which could cause the fund to underperform relative to funds with similar investment objectives. Property values or revenues from investments may fall due to: market disruptions, increased vacancies, declining rents, low demand, oversupply, obsolescence, competition, changes in prevailing interest rates or rates of inflation, or changes in state or federal taxation policies affecting real estate (unlikely but possible).

Weighing Tolerance for Financial, Impact, and Other Risks



- **Concentration Risk.** The WCIF will be exposed to industry and geographic concentration as the fund will be exclusively focused on physical development opportunities in Detroit.
- **Reputational Risk.** The Kresge Foundation may be held publicly accountable for the WCIF's performance, both socially and economically. In supporting the WCIF, Kresge is exposed to reputational risk relative to fund performance and community impact. Examples of reputational hazard may include potential foreclosure and debt collection obligations.⁵⁷

Three years later, in 2015, as the board considered setting aside a social investments pool of \$350 million, the list of risk factors had increased. To the first list, they added:

- **Contingent Risk.** The risk of being required to pay on a guarantee.
- **Fraud.** The risk that a social investment activity is fraudulent.
- **Implementation Risk.** The risk of errors in the evaluation and underwriting of the opportunities by Foundation staff, investees, or third-party partners.
- **Governmental Risk.** The risk of material changes in federal, state, or local policies that negatively impact existing investments.
- **Repayment Risk.** The risk that a borrower or project sponsor will be unable to repay a social investment, including the risk that material changes in federal, state, or local appropriations necessary for repayment will become unavailable.

In addition to understanding risk in a more sophisticated way, the staff also spelled out their risk rating and reserve policy to evaluate the risk of default by a borrower so that monitoring could be appropriate to the level of risk entailed from the lowest, at level one, to highest, at level five.⁵⁸

Rapson sums up the evolution of the Foundation's thinking about risk:

"... if you're operating strictly in a traditional philanthropic lane, taking a risk might mean ... doing what a nonprofit might struggle to do. But if you step outside that lane and co-fund or otherwise engage with the public sector and the private sector, ... you're entering space that neither the civic sector nor the public sector nor the private sector occupies. Not only do the orders of magnitude and difficulty increase, but so too does the inherent nature of the risk change. As the Foundation has become more sophisticated, more cross-sectoral, more cross-disciplinary, the risk just gets more and more complicated, nuanced, and central to what we do."⁵⁹

Questions for Consideration

- Did Kresge's definition of risk align with the sector's definition?
- How did Kresge's conception of risk change over time?
- What types of risk are most important when thinking about impact investing and blended capital deals?



Community and Equity: An Organization and City in Transition

Vignette 3—Community and Equity: An Organization and City in Transition

“The thing about diversity, is that it often gives the illusion of inclusion.”

—Marcus McGrew, The Kresge Foundation

Introduction

Every organization operating in the developed or developing world, whether funder or grantee, nonprofit or for-profit, faces difficult questions around equity—who holds power, who it hires and promotes, and who it serves. These questions may be framed in multiple ways and around

Community and Equity: An Organization and City in Transition



multiple differences—around diversity, race, gender, income, equity, inclusion, and privilege. Each of these terms means different things to different people, and each carries a complex, localized heritage depending on where and when it is raised in the world.

According to Independent Sector, a national consortium of nonprofit organizations and foundations, the argument for applying an equitable lens to social finance can be framed in four dimensions: moral, economic, market, and results. The field of philanthropy has been grappling with diversity, inclusion, and equity for many years. “An organization that prioritizes diversity, equity, and inclusion creates an environment that respects and values individual difference along varying dimensions. In addition, inclusive organizations foster cultures that minimize bias and recognize and address systemic inequities, which, if unaddressed, can create disadvantages for certain individuals,” according to Independent Sector.⁶⁰

As an expander of opportunities in America’s cities, The Kresge Foundation grapples with these issues frequently, especially through its work in Detroit, where issues of race and equity are highly volatile given the city’s cultural and political history, and where the racial tensions of America’s current political climate often find traction. On issues of equity and inclusion, both the organization and the city are on paths of transition. As Rip Rapson, Kresge’s president and CEO, puts it, “There is inherent power in philanthropy’s perceived neutrality, its ability to take a long-term view, and its privilege of being able to work on behalf of underrepresented people, ideas, and causes.”⁶¹

Philanthropy, Institutional Privilege, and Place-making

The Deliberate Leadership framework begins with an appeal to place community at the center of social investors’ work. As Figure 10 illustrates through the example of Lamisi, a woman in rural Ghana, starting with community at the center reveals issues of relevance and how they are intertwined. This is no less true than for The Kresge Foundation, which places people at the center of its work. “We believe that all people should lead self-determined lives and participate in the economic mainstream. How do we do that?” Rapson asks.⁶²

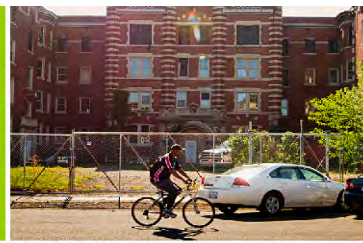


Figure 10. Lamisi's Circle



And how do you do it so that marginalized people and communities benefit from the work and remain at the center?

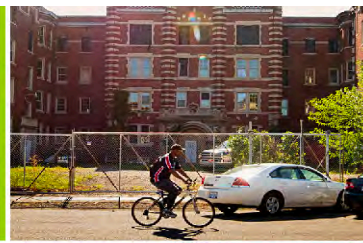
Achieving equity also involves understanding how privilege operates. For foundations and grantmakers around the world, questions of equity and privilege are not new and are difficult to ignore. Charges of institutional privilege are frequently leveled at philanthropy, and the top-down flow of capital in the sector can mean that those on the ground are disempowered and too far removed to be heard. As Kathleen Enright recently wrote in *The Huffington Post*, “For many in philanthropy, privilege is a blind spot.”⁶³

Darren Walker, the president of the Ford Foundation, speaks of the “paradox of privilege” that “shields us from fully experiencing or acknowledging inequality, even while giving us more power to do something about it.”⁶⁴

Implicit in this statement is an acknowledgement that the power to give money away often comes from the privilege of being able to amass it in the first place. For this reason, Walker suggests that philanthropy has an “obligation to strengthen capitalism,” because capitalism makes philanthropy both “possible and necessary.”

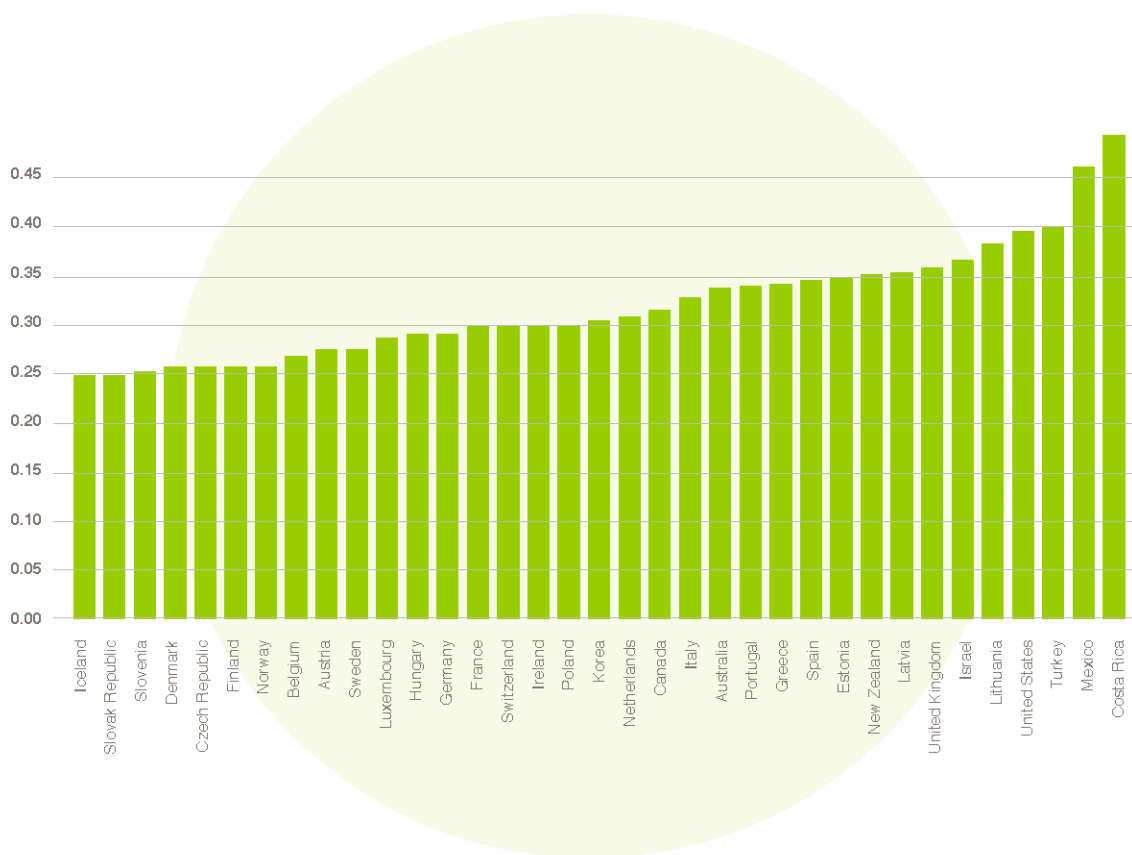
Reflecting on the origins of private foundations in the United States, whether The Rockefeller Foundation, Ford Foundation, W.K. Kellogg Foundation, or Kresge itself, their philanthropic endowments have been made possible by corporate profits in a free market. This is not significantly different from foundations created more recently, such as the Bill & Melinda Gates Foundation or the Chan Zuckerberg Initiative.

Community and Equity: An Organization and City in Transition



Despite conscious attempts to address it through values-based change, the persistence of privilege leads some to ask if perhaps capitalism is itself the root problem.⁶⁵ OECD's 2014 data on income inequality reveals that countries that show the lowest levels of income inequality, such as socially democratic Scandinavian countries, also exhibit the lowest levels of philanthropy.⁶⁶ Capitalist democracies, like the United States, which also depend heavily on philanthropy, are on the other end of the spectrum of income inequality (See Figure 11). Causation and correlation between capitalism, philanthropy, and inequality are difficult to establish, but raise the question, "Is philanthropy's obligation to strengthen capitalism or to transform it?" And under a transformed capitalist regime, would philanthropy still exist?

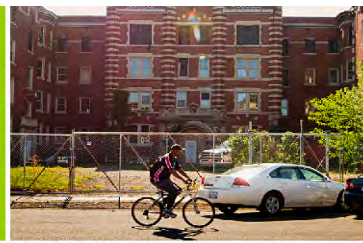
Figure 11. Global Income Inequality by Gini Co-efficient 2014⁶⁷



Within this paradigm, what are the right levers a foundation can pull to tackle questions of privilege? The Kresge Foundation made a concerted effort to do this, as articulated through the Foundation's values of stewardship, respect, creativity, partnership, and opportunity.⁶⁸ Its staff members also undergo diversity trainings, and some of its leaders, like Lois DeBacker, managing director of the Environment team, have been recognized for promoting diversity and inclusion in their fields. This is a form of tackling privilege through values-based cultural change.

Yet, the process of engaging with internal and external institutional privilege will continue to remain challenging for philanthropy. According to racial equity practitioners, Gita Gulati and Maggie Potapchuk,⁶⁹ the most common and thorny challenges are as follows:

Community and Equity: An Organization and City in Transition



- **Privilege is usually normalized and difficult to see.** It is difficult to examine something that you don't consciously know exists.
- Foundations, being used to looking outwards at external communities, find it **difficult to turn the mirror inwards** and are usually not prepared for the emotional responses and conflict that this necessarily generates.
- **The change process can itself “privilege the privileged,”** by centralizing and accommodating their (steep and lagged) learning curve. This is a necessary process, but it can often be frustrating for those who feel called upon to repeatedly prove their lack of privilege.

Marcus McGrew, director of Program Operations and Information Management, echoes some of these sector-wide challenges through his experiences, even at a foundation like Kresge, that impede concerted efforts to address issues of diversity: “I've learned to embrace being the dissenting voice, because I think it is necessary, and it will help us.” The research supports his theory, as organizations that purposefully incorporate diverse experiences and viewpoints have been shown to exhibit greater creativity in problem-solving and greater productivity.⁷⁰

Composition of Internal Teams

The composition of teams is an important factor when applying an equity lens. James Surowiecki, journalist and author of the *Wisdom of Crowds* says, “Groups that are too much alike find it harder to keep learning, because each member is bringing less and less new information to the table.” Several Kresge staff agreed that in many cases the Foundation is attracting people who are alike, which can exacerbate the culture of privilege.

Kresge Demographics

While demographics do not necessarily address the issue of privilege, they do help understand the Foundation's commitment to inclusion and equity. A rudimentary analysis of Kresge's demographics based on sex and race indicates that the organization is predominantly female (62 percent) and that white people form a marginal majority (55 percent). White women dominate leadership positions (seven of 18), including that of the board chair, but it is women of color who form the largest group across the organization (36 of 110). There are 14 men of color across the 110 people in the organization. In contrast, there are double the number of white men—the second smallest group. Seven of 17 teams contain no men of color at all, including the Executive Office. Another notable observation is that, of the 14 people on the Investments team, two are people of color, and four are women.

Kresge's demographics reflect the trends in the US philanthropic sector as a whole, where white people and women form a majority.⁷¹ Kresge also reflects the sector-wide trend that more people of color populate the administrative and professional levels than the executive (see Figure 12). While the sector displays a similar trend for the representation of women, Kresge displays the opposite trend, with 11 of its 18 team leaders being women.

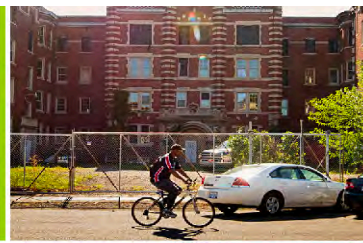
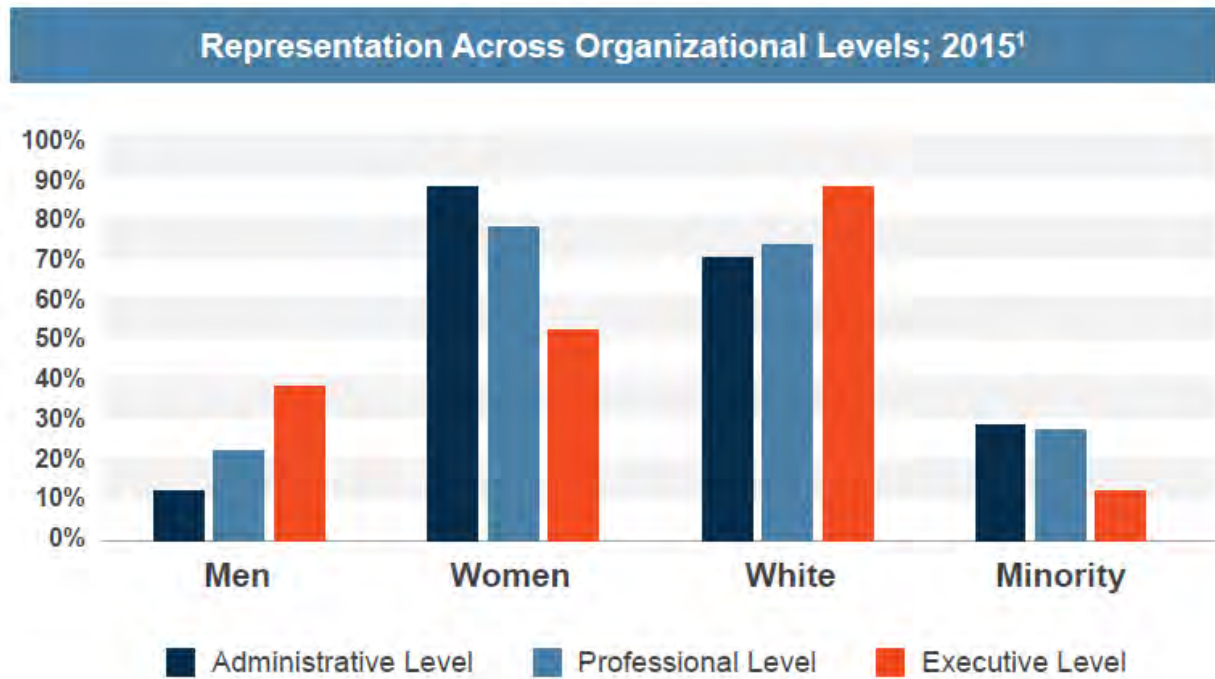


Figure 12. Foundation Diversity in US Philanthropy⁷²



What should Kresge's staff represent in diversity? Figure 13 illustrates Detroit's changing demographics. For example, should the Detroit team or The Kresge Foundation overall represent current city demographics? Would that address issue of privilege and equity? These are questions the Foundation staff are grappling with as they seek to live their values of opportunity and inclusion.

Even organizational strategies, such as the location and conditions of an office, can create or challenge cultures of privilege.⁷³ The Kresge Foundation recently completed Phase 2 of its expansion plan for the corporate headquarters in Troy, Michigan. David Fukuzawa, managing director of Kresge's Health and Human Services Programs, questions whether choosing a location outside of Detroit reinforces the image that Kresge is "a part of the institutional elite...trying to take over the city." Sensitivity about this issue, coupled with a desire to contribute to and accelerate the revitalization of Detroit's Midtown area, led the Foundation to establish an office in the city.

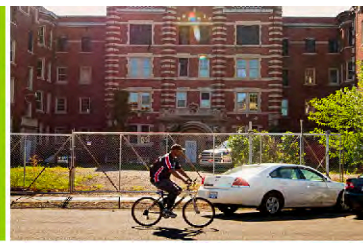
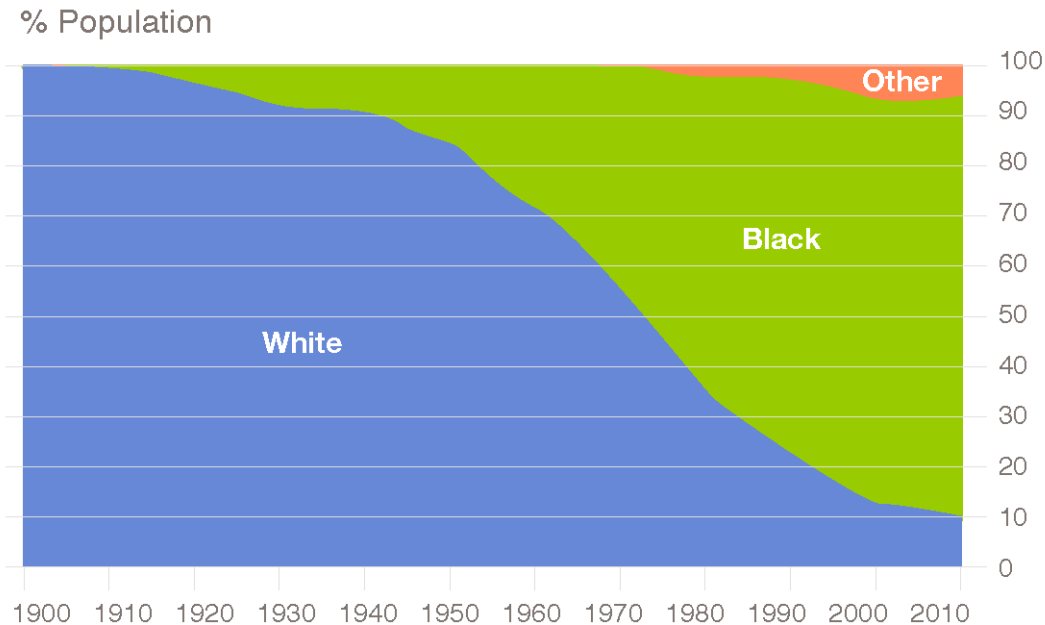


Figure 13. Detroit's Changing Demographics⁷⁴



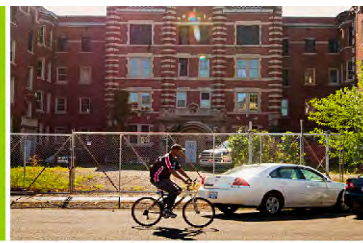
Source: US Census Bureau I FT graphic: Joanna S Kao

All of these examples and questions indicate an organization in transition that is genuinely taking on the complex business of building a truly inclusive internal community.

Grantee Perceptions

If community is at the center of the work, then how organizations listen and learn from community becomes an important part of equity work, especially around issues of power. “I think it also needs to make notice of the power dynamics that really exist between foundations and low-income communities and people who reside there,” says one program staff. “I think we know that power dynamics exist between the two of us, but I don't think we are always cognizant of how that shows up. Just being in the room with [a funder] can be intimidating to a grant-seeking organization. It can cause mission drift for nonprofits, because they're, I think, at times, willing to do almost anything to get a Kresge grant or a PRI,” says McGrew.⁷⁵

To gather feedback from the grantee level community, The Kresge Foundation uses the Center for Effective Philanthropy (CEP) grantee perception surveys. According to the latest report (2014), the Foundation has a good reputation for its impact on grantee fields and organizations. This sentiment was echoed by CDFIs in interviews for this case study, such as Scott Sporte, who says that Capital Impact Partners owes its CDFI status to Kresge, and David Blaszkiewicz, CEO Invest Detroit, who admires that Kresge is at almost every important table in the field. Kresge funds various initiatives to keep track of community feedback, for instance the Detroit Future City Framework, which creates a “blueprint for Detroit's future” based on tens of thousands of interactions with Detroit residents and civic leaders.⁷⁶ A more recent initiative, Data Driven Detroit, takes a data-driven approach to mapping out needs and demographics in distinct Detroit neighborhoods.⁷⁷ And the Foundation has, for the last ten years, convened the



monthly Detroit Neighborhood Forum, gathering banks, government, and philanthropic groups to share information about, and align strategies for, the revitalization of the city's neighborhoods.⁷⁸

A deep-dive into Kresge's interactions with community and equity in Detroit provides important lessons and raises many questions for anyone in social finance.

The Larger Equity Challenge of Working in Detroit

In 2014, Nolan Finley wrote an article for *The Detroit News* provocatively titled, "Where are the black people?"⁷⁹ In the article, Finley says, "Near the top of the list of the challenges Detroit faces as it starts its post-bankruptcy era is avoiding becoming two cities—one for the upwardly mobile young and white denizens of an increasingly happening downtown, and the other for the struggling and frustrated black residents trapped in neighborhoods that are crumbling around them."⁸⁰

This narrative of two Detroits plays out in the media frequently, whether in the *New York Times* ("Detroit's 2-Speed Recovery, Downtown Roars and Neighborhoods Sputter"),⁸¹ or in frustrated, viral blogposts by members of the community ("Why I Hate Detroit").⁸² This dual narrative was also displayed during the 2016 US Presidential campaign, where Trump's depiction of Detroit was one of "poverty, crime, and blight," while Clinton told audiences that Detroit exemplified an "upbeat comeback story of grit and innovation."⁸³

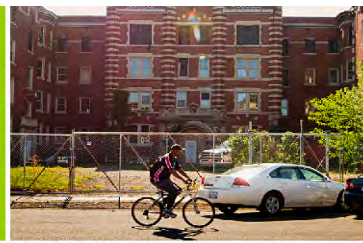
Against this socio-economic and political backdrop, Kresge's work in Detroit and its initial focus on reviving the city's commercial core has drawn praise and deep scrutiny from different quarters. Rapson, as well as the former and current managing directors of the Detroit team—Laura Trudeau and Wendy Lewis Jackson—do not see the narrative of two Detroits as a fair characterization of their work.

"I think the characterization doesn't reflect or recognize that we are talking about one Detroit," says Lewis Jackson, managing director for the Detroit Program. "And the comeback story is ongoing. Part of it started in a concentrated place, the Midtown and the downtown core. Now the next challenge, or opportunity ... is how can we bring neighborhoods back online in Detroit with equity at the forefront and ensure a complete, inclusive recovery?"

Laura Trudeau, former managing director of the Detroit Program, agrees, saying, "Even though a lot of folks think that our investments were concentrated in Midtown and the downtown area, they really were not. We made a lot of investments in neighborhoods. In many ways, the impact of those investments was not felt, because there were so many other negative forces working against neighborhood stability."

According to Trudeau, it was Kresge's plan all along to bring about neighborhood stability, but this could only be achieved after reviving the city's core and creating a broader base of support for neighborhood reinvestment: "People who are armchair quarterbacking at this point are missing that part of the strategy ... but that really was always the plan. We didn't know if it would work. Fortunately, it did."

Rapson echoes this sentiment: "It was never our intention to make a binary choice to invest in either the central business district or the neighborhoods. There's just no question that you had



to do both. I think what ended up slanting people's perception of what was going on was the visibility and the amount of capital stacking that occurred in the central business district and along Woodward," he says.

Making Equity Explicit

Three months before Trudeau was due to retire as managing director of the Detroit team and Lewis Jackson and Benjamin Kennedy were about to take the reins, the Detroit team submitted a memo to Kresge's board outlining eleven lessons learned from the team's work in the city. Lesson seven was "to incorporate an explicit equity lens to our work." This lesson was born out of three sources.

The first, a community development consultant in 2010, highlighted the "perception by some Detroiters that Kresge is a white-led, prosperous, suburban institution." Irrespective of whether this was a fair or unfair characterization, it is undoubtedly a problematic reputation for a foundation to hold in a city where nine out of ten residents are people of color.

The second was a report from the CEP survey in 2015, which noted, "While the Foundation is openly committed to fostering economic opportunity in low-income communities, it does not always explicitly use a racial equity lens, weakening its strategic commitment to opportunity." And the third was direct feedback from Detroit citizens, flowing from dozens of meetings in neighborhoods to get advice on how the Foundation could be most helpful to residents.

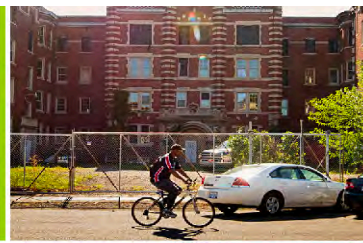
Lewis Jackson and Kennedy's Detroit memo goes on to note, "Kresge has incorporated equity into its strategies in numerous ways. But it is increasingly apparent that there is value in 'naming and framing' the challenge posed by such profoundly deep and troubling racial disparities as exist in Detroit, particularly those that present structural barriers to opportunity. We intend to identify concrete steps in this direction by including equity considerations in our strategy (what we do) and changing the way we do our work (how we work)."

One of these concrete steps has been to intensify its commitment to strengthening Detroit's neighborhoods. "It is important to resuscitate the core of the city," says Kennedy, "but a city is only as good as its neighborhoods—all of its neighborhoods."⁸⁴

"Our remarkable success in the downtown and Midtown, for example, struck some as out-of-balance—other communities appeared to be marginalized, or at least an after-thought. As new residents with higher purchasing power began to populate the city, a fault line began to emerge between the so-called 'hipsters' and community members, particularly those of color, still struggling to make ends meet or being displaced by increasing housing prices," says Kennedy."⁸⁵

From interviews with multiple Kresge staff members, it is uncertain whether an explicit and shared racial equity lens has been incorporated across program, SIP and investment teams, while screening grant applications or investment opportunities. SIP managing director Kimberlee Cornett and chief investment officer Robert Manilla confirmed in interviews that, other than a broad commitment to charitable purpose, their teams do not apply any explicitly defined equity screens to PRLs in Detroit and endowment investments in real estate.

Lewis Jackson explains that the Detroit program team, on the other hand, has developed an explicit racial equity commitment. Their work is guided by a formal statement, Kresge's Detroit Program Team's Commitment to Racial Equity. Their working definition of racial equity



describes the team's commitment to the outcomes of their work as well as the way they work.⁸⁶ According to the statement, "The Detroit program team is committed to advancing racial equity, both as a team and in our community. This commitment is central in our ongoing process to embed principles of equity and empowerment in the financial support we provide and to our journey to continuously improve the way we work."⁸⁷

For the Detroit program team, it is still being tested whether or not rigorous, explicit equity screens are imperative to the efficacy of their focus on neighborhoods. Two of the neighborhoods that the team has chosen to focus on first—East Jefferson and North End—are home to a higher proportion of African Americans on average than in Detroit as a whole.⁸⁸ Another area of interest—Southwest Detroit—is a predominantly Latino neighborhood.⁸⁹ The median income levels of all three neighborhoods trend below the city-wide median of \$31,354.⁹⁰ At the same time, the team is also focusing on the area surrounding Marygrove College, the University of Detroit Mercy, and the Detroit Golf Club, which encompasses both some of the city's poorest neighborhoods and some of its most affluent. The area was buffeted severely by the foreclosure crisis, and some call it the "tipping point neighborhood, one that may be able to get back on its feet after a bruising few years. Or not."⁹¹ Therefore, funders like Kresge are needed in each of these areas, but for different reasons and with varying levels of urgency.

When the tale of two Detroits is reduced simply to a "black and white issue," both literally and figuratively, it "is not a true diversity discussion," says Invest Detroit's David Blaszkiewicz. "Gentrification and displacement are real potential future issues and that is where our opportunity exists. To that end, there has been a great deal of discussion—and occasionally tension—around this issue, which I think is mostly good. Having an open dialogue with existing and new residents, business owners and other stakeholders is how we get to the right answer. We, as a community have the opportunity to address this in ways that other communities have not. This is a once in a lifetime opportunity." Another lifelong Detroiter on the Kresge Executive team, Sharon Zimmerman, makes a similar observation about those who claim the city as their own: "I'm a native-born Detroiter. I don't want to feel like a stranger here."

This discussion is not unique to Kresge, and importantly, the organization is responding to challenges and making changes both internally and externally. As McGrew puts it, "Race is still used to advantage some and disadvantage others. I just think we need to have that conversation in a way without judging anyone personally. Talk about the systems, talk about the injustices that are being allowed to endure for far too long, and then roll up our sleeves and do the work."

Questions for Consideration

- How can you incorporate a meaningful equity lens into social finance?
- What can social finance and the flow of capital do to make inequity visible and help overcome it?
- How does any place-building initiative decide which community members to place at the center of Lamisi's Circle?
- To what extent and in what way should funders' internal teams reflect the communities they seek to serve?



Creating Alignment and Cultural Readiness for a Social Investment Practice

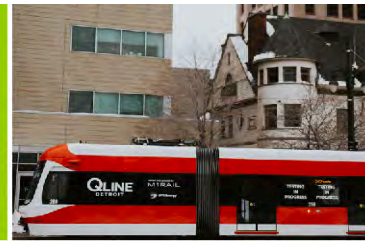
Vignette 4—Creating Alignment and Cultural Readiness for a Social Investment Practice

“Progress is impossible without change, and those who cannot change their minds cannot change anything.”

—George Bernard Shaw

Kresge Foundation board chair Elaine Rosen opened her letter in the Foundation’s 2015 Annual Report with the words quoted above. 2015 was the year that Kresge’s board allocated 10 percent of its endowment—\$350 million (\$300 million through PRIs, \$50 million through MRIs)—to be deployed through social investments by 2020. For a foundation that was a

Creating Alignment and Cultural Readiness for a Social Investment Practice



traditional grantmaker for 83 years, getting to this milestone required repeatedly embracing multidimensional cultural and behavioral change—a process that began in 2007 when Kresge launched its Social Investment Practice (SIP) and that continues a decade later. Explaining the relevance of Shaw’s words, Rosen says, “When you’ve been involved with so many organizations, whether serving on their boards or running them...you know it really all comes down to culture and people and leadership and how you get people’s arms around it.”

How an organization gets aligned with its culture is a particularly important theme in Kresge’s SIP story. It is also an important topic for US and global social investors who are struggling with issues of integrating social finance perspectives into their grantmaking culture and portfolios. An estimated 100 US foundations in 2016 invested \$64 billion in impact investing resources. The field is growing globally with the addition of family offices and wealth managers. The need to find ways to bridge the culture and knowledge divide across sectors and disciplines is becoming even more important. The lessons learned in this vignette are about creating the right culture to bridge silos, beliefs, and cultures and to fully integrate social and finance together within an organization.

When asked what Kresge offered the field, the director of Impact Investing at The MacArthur Foundation, Debra Schwartz, explains, “In addition to Kresge having a highly competent staff and board, they are testing new approaches for integrating impact investing efforts into their philanthropy. Their lessons are something from which we can all learn as we strive to do likewise.”

President and CEO Rip Rapson has recognized the challenges the Foundation faced in uniting a team around common social investing goals. His observations about lessons on leadership and cultural readiness at the 2016 Mission Investors Exchange Annual Conference in Baltimore are noteworthy.

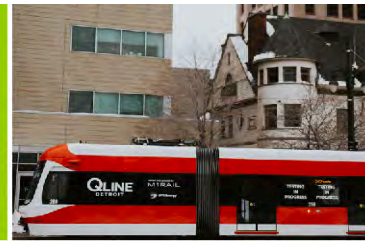
“The adage that ‘culture trumps strategy’ is true with a vengeance in the realm of social investments,” he said at the time. “Introduce a foreign object into a grantmaking monoculture and chances are pretty good that the antibodies will reject it forthwith.” He continued to explain that social investment requires a different way of thinking, planning, and acting. Rapson was clearly aware of the necessary cultural shift he was leading. “We had to demonstrate that the introduction of social investments was not a zero-sum game—that rather than diminishing the resources available for grantmaking, social investments augmented the resources available to our program teams.”

Understanding why this was difficult at Kresge and in the philanthropic field in general requires an understanding of the Foundation sector’s business model and the microcultures it can create.

Kresge’s Philanthropic Model and its Microcultures

Organizational culture is the personality or character of an organization. Microcultures of smaller groups can form within an organization.⁹² Each group can have distinct assumptions, values, and working behaviors. A study of microcultures by Grantmakers for Effective Organizations (GEO) explains: “They are the first level of connection that staff and board members have with our organizations, they drive how work gets done each day, and they can make or break our

Creating Alignment and Cultural Readiness for a Social Investment Practice



larger efforts to create strong and cohesive organizational cultures.”⁹³ Some microcultures can push the organization at large to adopt more effective grantmaking, while at the same time microcultures can subvert organizational cohesion, reinforcing divisions and promoting competition between groups.

People often tend to identify more closely with their microcultures than with the culture of an organization overall—something that is attributed to the simple human tendency to seek out connections with those with whom they share “experiences, characteristics interests, affinities and identities”.⁹⁴ While microcultures can form informally based on shared backgrounds, race, etc., formal microcultures are those that form around how people are positioned within the larger organizational structure, based on their titles, roles, office locations, or departments.⁹⁵

The Philanthropic Model

Due to silos and the traditionally hierarchical forms of functioning that philanthropy inherited from its three major source-institutions—banks, universities, and for-profit corporations—formal microcultures tend to become deeply entrenched within foundations.⁹⁶

Though private foundations are best-known for making charitable grants, Figure 14 illustrates that they actually deploy a wide spectrum of capital. Their ability to provide grant capital to social causes is made possible by a gift of capital from their founders that generally must be preserved and grown through investments that generate market rate financial returns. CEO of the Heron Foundation, Clara Miller, says that philanthropic model has hardly changed since the original 1913 mold of the Rockefeller Foundation. She describes it as, “‘Daddy’ makes the money, and ‘Mommy’ gives it away”—an approach that assumes that social and financial benefits are separable and exist in different spheres, a belief reinforced by the foundation business model.

For instance, Sebastian S. Kresge’s initial gift of \$1.6 million in 1924 has grown into The Kresge Foundation’s current endowment of \$3.5 billion. US tax regulations only require that 5 percent of this endowment be deployed to meet a philanthropic mission every year, either through grants or below-market-rate investments (PRIs).⁹⁷ The remaining 95 percent is typically put towards private investments that generate market-rate returns and that have little or no connection with charitable purpose. Some foundations like the Bill & Melinda Gates Foundation have even come under public scrutiny for private investments that have gone towards controversial sectors such as oil and gas or tobacco.⁹⁸

The skills, values, priorities, and culture of the teams making grants differ from those of the teams making conventional private investments. As GEO describes it, “Members of program microcultures sometimes may perceive themselves and their work as the heart and soul of the organization, given their frontline interaction with nonprofits and the community and their role in approving and administering grants”.⁹⁹ Others making market rate investments may view themselves as the stewards of the endowment, without whom the program teams would have nothing to give away. When impact-focused investment teams were added at The Kresge Foundation, the line between charitable and financial objectives became even more blurry.

Kresge’s Microcultures

Figure 14 below illustrates how Kresge teams are divided across the Foundation’s investment spectrum. Six program teams—Detroit, Health, Human Services, Environment, Education, and

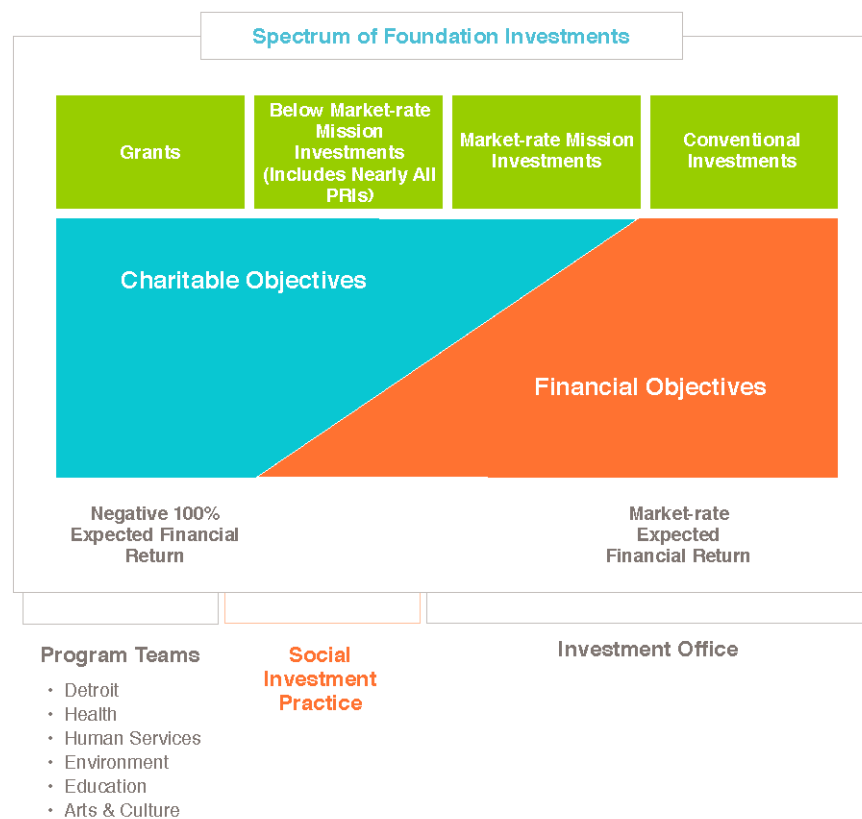
Creating Alignment and Cultural Readiness for a Social Investment Practice



Arts & Culture—focus on different social issues and make grants. Each team has up to two managing directors and about three-to-six additional staff. The Investment Office, led by vice president and chief investment officer Robert J. Manilla, is a 14-member team that sits in a different part of the Kresge headquarters, along with the Finance team. The Investment team handles MRIs and conventional endowment investments. The SIP team is responsible for below market rate PRIs that promote Kresge’s philanthropic mission.

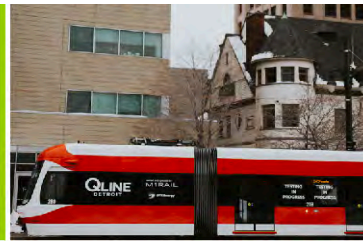
David Fukuzawa, managing director of Kresge's Health and Human Services programs, refers to microcultures as different species: “It's not so much we're in our own silos; we just commune with our own species. If you're in the social justice, social change space, you tend to be very mission driven and very people focused. We have passionate people who think that cash and capitalism are evil. Then you have people, obviously, on the finance side, who think the world revolves around the dollar. It's very rare to have those spheres interconnected.”

Figure 14. Kresge Organizational Structure¹⁰⁰



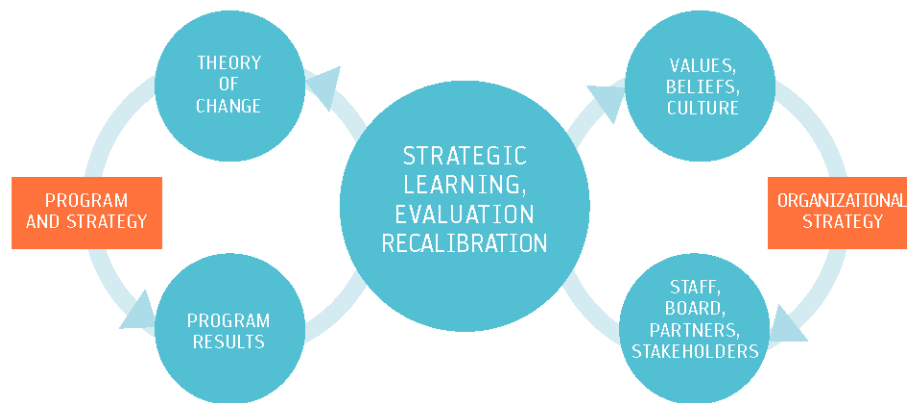
Creating horizontal alignment and collaboration across these teams has not been an easy task. Organizational change expert and Harvard Business School professor emeritus, John Kotter, posits that non-alignment creates significant inefficiencies that consume resources, drain people’s energy, and take time and effort to correct.¹⁰¹

Creating Alignment and Cultural Readiness for a Social Investment Practice



As Figure 15 below illustrates, organizational infrastructure underpinned by organizational values, culture, and beliefs, determines programmatic strategy, which in turn decides theories of change and program results.

Figure 15. Balancing Organizational and Programmatic Strategy



Kresge's Five Point Acculturation Strategy

Strategy 1: The Bull's-eye Drives Grantmaking and Investment Decisions

Rapson outlined a five-pronged strategy for creating internal cultural alignment for social investments. "First, we insisted that a social investment had to advance directly the objectives of our program teams," says Rapson. This is what has come to be known amongst Kresge staff as the "programmatic bull's-eye"; the idea is that it is not enough for PRIs and MRIs to go towards the Foundation's broad charitable purpose, but that they instead have to be "indistinguishable in their purpose from our grantmaking." This means that the six program teams define the specific areas where the SIP team and Investments team can deploy PRIs and MRIs that meet their return targets (See Figure 16).

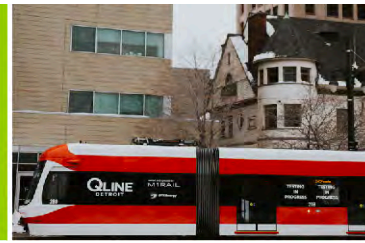


Figure 16. The Programmatic Bull's-eye for Potential Investments



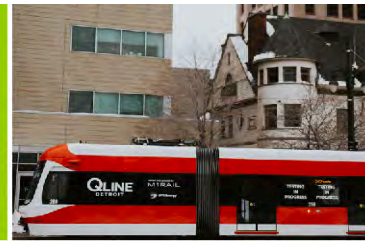
Even though the programmatic bulls-eye is the clearly articulated policy guiding social investments and mission related investments and even though the program staff believe it ensures broad organizational alignment, there is a legitimate conversation to be had about whether the boundaries of the inner-circle should be flexible over time. The social investing team, for example, has made the case that the bulls-eye may sometimes be too narrow for creating deals with different partners and generating investment opportunities. From that perspective, they have argued that the bulls-eye could be directional, not prescriptive.

Director of Strategic Learning, Research and Evaluation, Chera Reid, says that the bull's-eye has been a pain point, since it raises the question, "Whose strategy leads, wins the day, if you will?" Reid recalls one situation when a collection of two-dozen SIP team deals were sent back for further development and discussion to ensure that they did, indeed, meet the programmatic bull's-eye. Although the programmatic alignment issues were resolved, the social investment team felt frustrated at having to go through what they viewed as an extra, burdensome step.

Another challenge to tying social investment to the bulls-eye was that programmatic strategies change over a shorter time frame than do social investment decisions. Trustee Jim Bildner explains, "With the refreshing of program areas every three to five years, the bull's-eye, per se, changes on that cycle, whereas PRIs and MRIs are often more long-term instruments stretching 10 to 20 years."

Cornett agrees, "Where the change in programmatic strategies really hits hard is when you get to year four or five or six and the deal needs grant funds," she says. At this point, program

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strategies have likely moved on, meaning that the deal is no longer in the bull's-eye, and program teams have no incentive to “fund a problem we encounter in our long-term investment.”

Environment team leader Lois DeBacker acknowledges that shifting programmatic strategies do make the bull's-eye framework “tricky,” but believes that an alignment framework is necessary to ensure the efficacy of both grants and social investments, “because they both need to be producing meaningful impact. It's more, in either case, than just shoveling money out the door.”

For now, the tension over the bull's-eye was settled by leadership: program strategy informs social investment decisions. They offered additional solutions to bridge the programmatic and financial divide as described below.

Strategy 2: Capital Diagnostic

Rapson's second strategic imperative was to “elevate the idea of a capital diagnostic.” This required teams to start with a problem, then ask how the absence of capital flows contributed to that problem and what combination of capital types would open up those flows. According to Laura Trudeau, former managing director of the Detroit team, this requires teams to recognize that “money is the tool of philanthropy” and that collaborating across the program teams, the SIP team, and Investments team helps everyone share knowledge and “understand money better.”

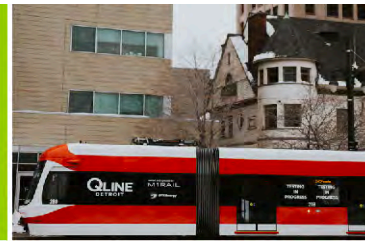
In 2008, an internal Capital team that included Manilla and Fukuzawa submitted a memorandum to the board building on this idea:

“As a financial tool, PRIs introduce a new way of looking at social issues, connect the Foundation and nonprofit organizations to new potential funding partners (including government and for-profit investors), and bring new sources of capital to fields and complex issues...While PRIs are clearly not a one-size-fits-all tool suitable for every nonprofit organization, our initial exploration suggests that the integration of PRIs into the Foundation's broader capital toolbox is a powerful way of increasing our impact and leverage to meet mission and program priorities.”

For some program directors like DeBacker, this way of thinking has been instrumental in convincing her of the value of social investments. “I think it forced the program staff to be able to think about where access to capital is a barrier to making progress,” she says. DeBacker notes that the program teams have seen how the use of social investment capital can leverage other money in ways that grants can't. “I think we've also come to understand how grants can help with pre-development of deals that can then become social investments,” she adds.

Her latter point is one that Kimberlee Cornett, SIP managing director, has come to agree with strongly: “There are very good illustrations of that in Lois' work, where I think some of the grantmaking that she has done has really set the table, for now, for the investments that we're trying to make in or around community resilience.”

It has admittedly been a journey for Cornett, DeBacker, and other team members to become conversant with multiple forms of capital, but the framework of a capital diagnostic has accelerated progress.



Strategy 3: Budget Considerations

Third on Rapson's list of strategies was the budgetary prioritization of social investing. "We initially placed our social investments on top of our grantmaking budget—expanding our budget to include additional monies dedicated to social investments," he says. When Kresge introduced the Social Investment Practice in 2007, Rapson had to approach this issue sensitively, particularly against the backdrop of the global recession and its potential impact on the Foundation's endowment. He recognized that a completely new, unproven initiative that would eat into the grant budget, introduced by a new CEO, would likely not be well-received by program staff. Therefore, the decision was taken to allocate funds to start with which would sit on top of the grantmaking budget of about \$157 million per annum until SIP developed enough credibility to sit alongside grants. "As we gradually created ever-more compelling proof points of how social investments could be inter-braided with grants," says Rapson, "we would feather both types of dollars into a unified budget."

The decision in 2015 to allocate \$350 million towards social investments over five years was a validation of the SIP team's track record. However, it also increased pressure to take some of this capital out of the grant budget to avoid having the Foundation's total spending levels balloon to unsustainable levels. The working group assembled to analyze the feasibility of the \$350 million allocation noted that, based on a conservative estimated return on Kresge's corpus of 7.2 percent per annum, "there is an imperative to move the cash SIP budget inside the payout target as quickly as it is prudent and feasible to do so—it currently sits 'on top' of the payout." They went on to add, "We also propose holding the grants budget relatively constant (currently \$135 million) between now and 2020, perhaps with small annual increases."

DeBacker admits that budgetary concerns do raise questions in her mind: "I think that part of where the tension emerges is around the budget. There's only so much money we can spend, even if you're having it repaid. The social investment dollars were on top of the grant budget originally; now they're competing with the grant budget essentially because we can only afford to put so much cash out every year." She further admits that this strengthens her resolve for strong programmatic alignment and the bull's-eye approach. Several staff agreed this remains an area of concern.

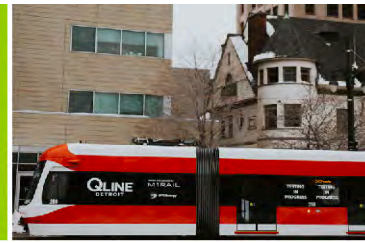
Strategy 4: Cross Training and Building Trust

Rapson was also committed to hiring staff with expertise across social finance and traditional grantmaking. He explains, "This meant social investment folks with grounding in program expertise, and program folks with the ability to assess capital needs."

Senior fellow, Fred Karnas, explains that when existing staff were asked to consider incorporating social investments, the response was, "We do grants. This is complicated weird stuff." Karnas also felt staff had concerns that this would require learning new skills. Jim Bildner agrees: "The staff believed that to loan money to entities was a fundamentally different capacity and skill set from giving free money...That is completely not true." However, whether these skill gaps were real or perceived, they posed as an obstacle to broadening Kresge's capital spectrum.

Staff hired prior to 2007 came primarily with grantmaking and community engagement experience. For example, Trudeau and Fukuzawa came with 28 years of experience in

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corporate giving and 20 years of experience in community engagement, respectively. They have both gone on to spend more than 15 years at the Foundation.

“Then,” says Karnas, “... In almost four years—from 2012 to 2017—we’ve gone from 60 people to almost 100 people ... [and] a lot of those folks who were program officers came on board with the full understanding that this [SIP] was one of the tools in the toolkit, and you needed to know something about it.”

Initial hiring decisions to accommodate SIP in 2011 focused on hiring people with strong investment banking experience, such as Cornett and later, SIP deputy director Kim Dempsey. Before that, the SIP team was one person—Cornett. Prior to joining Kresge, Cornett had spent seven years as vice president of the investment management division of a real estate investment services company in Maryland. During this time, she closed on equity investments worth \$1billion in affordable housing projects.¹⁰²

Her interview for Kresge in 2009 was for the role of director of Innovative Capital, and she interviewed with high-level leadership—Rapson, Bildner, Manilla, and CFO Amy Robinson—but not with program directors. She says the pitch made to her was very appealing: “You’ve been in this very structured finance position. Here you can be innovative.” However, there was no discussion of programmatic alignment and “I was too naïve to ask,” she says. “What I didn’t know was that Kresge didn’t really want social investments to operate independently from program ... and I’m not sure they knew it either.”

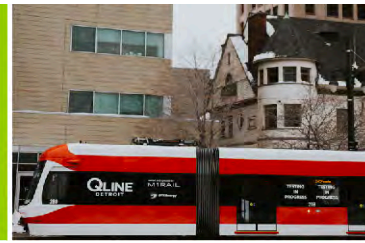
She had been tasked with convincing six program directors, each with significant grantmaking experience, that they ought to begin approving PRIs. Thinking through the SIP team journey, Dempsey says, “The image that comes to mind for me is Kimberlee being hired, sitting in a room by herself. Nobody is coming to see her. She finally decides to literally go outside the building and bring things in, throwing it like spaghetti against a wall [and] hoping it’s going to stick with somebody.”

Cornett encountered unexpected operational roadblocks. She tells a story of handling a new market credit transaction which had a very clear requirement that the deal had to close on a specific day. “We needed to fund at closing, only to discover that the Foundation only cuts checks on the 15th and 30th [of every month]. This was an operational system that was appropriate for grantmaking, but not appropriate for investment,” she says. That was one of the changes that was made to make SIP more efficient.

It was Fukuzawa and the Health team that was the first of the six program managers, to explore social investments. “I just basically started doing deals with David...the first two and a half to three years, I was so focused on just doing deals, because I thought that was the proof point that we needed,” says Cornett.

Her fervor for getting deals done, coupled with and her extraordinary creativity and drive earned her a reputation with some program staff as a “steamroller.” Early in her tenure, Cornett expressed concern that a particular grant Kresge proposal might be construed as “dumb money”—and that Kresge should always be seen as making “smart money” investments. Several program staff interviewees latched onto this characterization during the early days of SIP. According to DeBacker, “Early on there was a perceived attitude that program staff were not smart enough to get the financial side of the equation.”

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It's also critical to note that there were few, if any, organizational incentives in place to cause program staff to help work through these issues. If a program team didn't see the value in participating in the development of a social investments portfolio, they could simply elect to sit on the sidelines. That changed over time, but at the beginning, it was a difficult transition.

In looking back at SIPs evolution, DeBacker believes that tensions were intensified by the stress of Cornett having to build the SIP single handedly: "She's incredibly smart and incredibly driven, but didn't have the bandwidth to learn the program strategies, so there was actually some tension at the beginning. But, as SIP has matured and they've gotten more staff, it's become much more of a partnership."

Between 2014 and 2016, the SIP team expanded to include Dempsey, Aaron Seybert, and Joe Evans, all of whom have experience in social and financial sides. Seybert began his career in impact investing and affordable housing, Joe Evans was a consultant on social investing, and Kim Dempsey came from Capital Impact Partners, the Washington-based CDFI. Referring to social investors, Seybert says, "We function as this interesting bridge between folks with tremendous resources and folks with tremendous ambition to create social change. ... To me, our job is to convince those people [with resources] that value exists in low-income communities and to put those resources there."

Winning Strategy: SIP Integration into Program Teams

According to Cornett and the program directors, Seybert, Evans, and Dempsey have been instrumental in Kresge's transition story. Seybert works closely with the Detroit team, Evans with Finance, and Dempsey with some of the program teams like Environment and Education that have been slower to adopt PRIs. Dempsey says, "The key to success has been building trust with program colleagues. We are helping build strategy together. As a result, when we run into problems and need grant resources to help bridge a financial need, we can work with our colleagues to find ways to fill the gap."

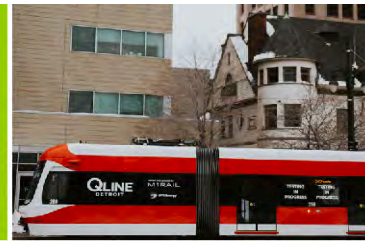
As proof of the transition, when asked about the next step for SIP, several program officers thought social investing experience should be a condition of being hired by the Foundation. Kennedy says, "In an ideal world, you want the agents of capital deployment, which are the program officers...to actually have all the tools at their disposal". Other managing directors like Regina Smith of Arts & Culture have also begun to contemplate the same issue asking, "I wonder in the future, if that's a skill set that you start to hire for or train for within our own department?"

Strategy 5: Communicate, Communicate, Communicate

The last element outlined by Rapson in his culture alignment strategy was communication. "We worked the soft tissue of attitude change by talking, talking, and talking," he says. "We needed an extended and respectful re-education campaign for really smart, dedicated program staff, who had been encouraged to pivot to a new way of working, but who needed to own that pivot themselves." This learning process was required for the SIP and Investments teams alike.

For instance, Rapson describes a "speed-dating" event organized by Cornett between the Investments staff and program staff "to create a baseline understanding within the Investment group of our social objectives and theories of change." Similarly, according to DeBacker, "Dempsey has established trust and credibility through her willingness to invest the time to go to

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grantmaker conferences to really learn—a recent example is a workshop that the Council of Development Finance Agencies put on about funding in water infrastructure.” Vice president and chief program strategy officer, Ari Simon credits the entire social investments team with “working incredibly hard to help the program teams understand possibilities, develop greater levels of comfort with new tools, and find creative ways to stay open to joint learning.”

Witnessing the Transformation and Bridging the Divide

Finance New Ways of Acting; New Ways of Being

Cornett is one of the first to admit she has gone through a transformation to better understand the importance and value of grantmaking. Over her seven years at the Foundation, Cornett and her team describe grants as groundwork—the base of the capital stack that is essential in getting Social Investments off the ground. Grants are also essential over the course of a long-term investment to provide “gap” capital. Building a SIP team that can work across program teams and open new ways to use capital to fulfill programmatic vision has been a major success.

Program Journey: The Story of Early Adopter and Slow Walk to Capital Stack

Health Team Finds New Capital for New Opportunities

Fukuzawa admits adoption of social investment practices was driven by urgencies and great need after the introduction of Affordable Care Act (ACA) in 2010. This major national legislation to expand insurance coverage to the under- and uninsured—the most vulnerable populations—coincided with Cornett’s arrival at Kresge. Speaking about Fukuzawa’s eagerness to collaborate, Cornett says, “It was at a time when capital needs and the working capital needs of Federally Qualified Health Centers had just gone off the charts because of the influx of the newly insured as a result of ACA. There was just no way you were going to move that needle with grants.”

Associate professor of Management and Organization Studies at Saïd Business School, Michael Smets’ work on leading organizational change states that credible leaders typically achieve success at creating change when followers view the change as desirable, feasible, and urgent.¹⁰³ For the Health team, the change introduced by social investments was all three of these categories, and therefore circumstances and attitudes aligned well for Fukuzawa to become an early adopter.

The teams’ work with community health centers paid off, leading to a \$100 million deal with Morgan Stanley to finance the centers and an award nomination for Financial Innovation of the Year by the *Financial Times*. These successes encouraged further collaborations between Fukuzawa and the SIP team, to the extent that the Health and Human Services teams closed about five times the number of social investments as other program teams between 2012-2014 (see Figure 17).

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Figure 17. Program Team Social Investments, 2012-2014¹⁰⁴



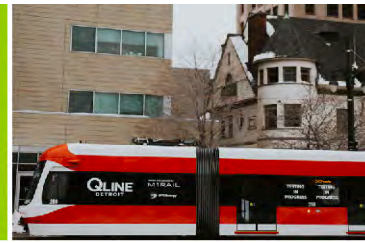
Environment Team: The “Slow Walk” to the Capital Stack

While the Health and Human Services teams were quick at adopting social investments, DeBacker’s Environment team took longer to embrace the idea of expecting a financial return on philanthropic capital.

DeBacker had more than 30 years of experience in grantmaking and environment policy and advanced degrees from Princeton University, but she did not have a background in finance. As Cornett describes it, “There was a whole lot of ground that had to be covered in order for Lois to get to the comfort level where she felt like she understood it enough to be willing to put the Foundation’s capital at risk.” For this reason, staff have described DeBacker’s journey of adoption as a “slower walk”, and hers was also one of the biggest transformations in mindset and behavior.

A turning point was when capital scans revealed the economic case of social investments within environment program objectives. “Where we have our most intentional partnership with the Social Investment Practice is in the energy and water work where they actually are some fundable demonstration projects,” says DeBacker. The Environment team undertook a number of capital scans to understand the capital needs of the various strands of their program strategy. One, for example, explored what kind of capital could be most effectively deployed in the realm of solar energy paired with storage in low-income communities. The results of all the Environment team’s capital scans were compiled into the investment heat map in Figure 18, and they opened deeper investment opportunities for blended capital stacks. DeBacker embraces

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the ability to generate new capital for climate change and other critical environmental areas. The term “capital stack” glides easily into her conversations about strategy and creating sustainable change.

Figure 18. Environment Investments Heat Map¹⁰⁵

	Storms	Drought	Sea Level Rise
Green Infrastructure (GI)	An excellent solution for stormwater management in urban contexts	Some opportunity for rainwater reuse for irrigation/toilets, limited investment potential	Financing solutions for coastal infrastructure to combat sea level rise
Planning & Preparedness	Climate planning is critical overarching solution for mitigating flood impacts	Securing diversified water sources is key to managing variability in rainfall	Planning is needed to build smart infrastructure to mitigate coastal damage
Distributed Treatment	Provides system redundancy during recovery in storm-impacted cities	Can pair well with greywater reuse in some areas	Applicable in places experiencing chronic saltwater intrusion or storm surge
Distributed Supply	Can provide system redundancy during recovery in storm-impacted cities	Desalination, rainwater harvesting, and greywater reuse are resilient supply sources, moderate investment opportunities	Alleviates supply loss from saltwater intrusion in aquifers
Water Monitoring	Not applicable	Usage and pipe monitoring directly results in water efficiency	Limited water quality monitoring opportunities help with storm surge
Water Efficiency	Not applicable	Large investment potential to scale up efficiency programs	Not applicable
Energy Efficiency	Negligible impact on severity of floods and storms	Some solutions achieve combined energy and water efficiency	Negligible impact on severity of sea level rise

Number of Investment Opportunities: ● High ● Medium ● Low ● Not Applicable/Negligible

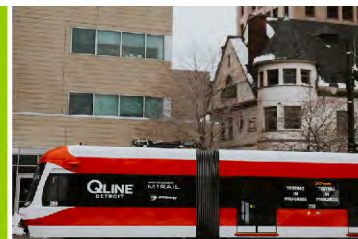
Unleashing the Endowment and The Big Unknown

While the SIP team was created in 2009, the Investments Office has been investing Kresge’s endowment in the private sector for much longer. However, when it comes to creating cultural alignment, CIO Manilla admits that the Investments Office has “the beauty of riding the coattails of all the work Kimberlee’s done with the Social Investment Practice.”

“We were clearly not the leaders in bridging the cultural gap between someone who’s only given grants and someone who’s only structured a credit deal to do home mortgages in Detroit,” says Manilla. “Kimberlee spent the better part of five plus years really cultivating that ground and recognizing that the problems we’re going after can sometimes, but not always, use different forms of capital.”

This is partly because the Investments Office does not have strong incentives to ensure programmatic alignment, other than through MRIs. Of the \$350 million allocated to social investments, \$50 million has been set aside for market-rate MRIs. Manilla, and Kresge in general, have a policy that investments must fall squarely within the bull’s-eye defined by program teams to be considered MRIs. That is not to say that the Investment team will not make

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other investments outside the bulls-eye – they do, and those may well either generally advance low-income opportunity in cities or meet broad environmental, social, or governance standards (ESG). When viewed through that lens, about a third of the Foundation’s investment portfolio land somewhere on the target. “It’s about a third in emerging markets, about a third in international non-emerging, and a third in the US,” says Manilla.

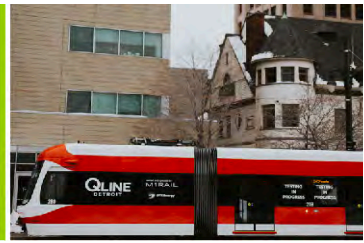
As a consequence, Manilla notes that Kresge’s endowment is partially invested in sectors or activities that contradict its philanthropic objectives—particularly its investments in oil and gas and high-end real estate. He adds that placing ESG or equity screens on endowment investments is further complicated by the fact that most investments are made at the fund-of-funds level and are not direct investments. This leaves Kresge with less oversight over where their funds are invested down the value chain.

Manilla and his team understand Kresge’s charitable objectives. “We are blessed to have in Rob Manilla a chief investment officer who is deeply passionate about our mission and our strategies,” says Rapson. Reflecting on his decision to join Kresge, Manilla states, “Part of what drew me here was the idea that I can do something I enjoyed doing. I think I’m pretty good at it and I can do it in an organization whose mission I believe in.” Manilla says his primary role is to indicate how many percentage points an investment or divestment decision may earn or cost the Foundation, but that it is ultimately the board’s decision about whether, or the extent to which, they want to map onto the investment portfolio an overarching ESG or equity lens of some kind.

That raises a fascinating and important question going forward for the Kresge Board. Is the Board comfortable with having parts of its investment portfolio work at cross-purposes with program strategy? If not, where can a clear line be drawn about where investment dollars will not move—in the face of environmental harm or inequitable land-use practices or threats to public health? And should the foundation be content with setting aside only \$50 million of its \$3.5 billion endowment for programmatically-aligned MRIs? If more, how much more? And should any of this be permitted to reduce the investment return of the Foundation beyond levels it might achieve through programmatically neutral market investments?

American foundations are answering these questions very differently. And it is a vitally important question to answer, as some \$865 billion resides in the endowments of American foundations.¹⁰⁶ Recently, the Ford Foundation removed made a \$1 billion commitment to mission driven investing, the largest commitment of its kind by a private foundation.¹⁰⁷ But that \$1 billion is carved out from the investment portfolio, is not managed by the Ford investment team, and is not calculated into the incentive compensation system the investment team earns for meeting its return benchmarks. It is accordingly one of many approaches that US philanthropy is exploring. A foundation like Kresge is likely to take a somewhat different approach, integrating is mission related investments directly into its investment function.

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Questions for Consideration

- To what extent is it practical and necessary to mandate that foundations invest 100 percent of their endowment in a manner consistent with philanthropic mission?
- Can impact investing through PRIs and MRIs be used to create alignment across foundations on their approach to the trade-off between financial and social returns?
- Given the organizational structure of Kresge at the time that SIP was introduced, were there other ways to build out SIP within the organization such that it would have been more readily received by program and investment staff?



Structuring a Blended Capital Deal: Leveraging Capital for Detroit's Woodward Corridor

Vignette 5—Structuring a Blended Capital Deal: Leveraging Capital for Detroit's Woodward Corridor

“Woodward Corridor was more than just a really interesting, sort of edgy, blended capital deal. It became the backbone for the city's revival.”

—Rip Rapson, president and CEO, The Kresge Foundation

When faced with the daunting task of reviving a city in crisis, where and how do you begin to deploy capital? Do you start with the symbolic high streets and concentrated commercial cores, where impact could be catalytic, or do you head straight for more diffused, at-risk neighborhoods, where community needs may be most dire? Who are the partners you can leverage? What are the different forms of capital you need to attract at each stage? These

Structuring a Blended Capital Deal: Leveraging Capital for Detroit's Woodward Corridor



remain challenging questions for leaders and investors in any city, but for The Kresge Foundation in 2007 Detroit there were no clear answers, and the need to act was critical. As the Foundation was considering investing its capital in new ways, the city where it was founded, Detroit, was spiraling towards the largest municipal bankruptcy in US history, filed in 2013. The prevailing image of the city was that of a “destitute, decaying city.”¹⁰⁸

The Foundation’s journey from this difficult moment ultimately led to the establishment of the \$30.25 million Woodward Corridor Investment Fund (WCIF) in 2013—a collaboration by a bank, two insurance companies, three foundations, and a Community Development Financial Institution (CDFI). According to Rapson, “this collaboration was one of the formative actions that led to the revitalization of the city’s central corridor, which in turn is one of the images people summon when they describe the renaissance in Detroit.”

WCIF provides permanent debt capital to projects that promote “density, diversity, vibrancy, and walkability in Detroit’s core.”¹⁰⁹ The story of the deal furnishes important lessons about why Kresge made deep early investments in the Woodward Corridor, about the importance of grant capital to a complex social investments transaction, and about how a blended capital deal of this kind could be pulled together in an environment unfriendly to commercial and residential real estate deals.

The Woodward Corridor: The First Moves of Place-building Through Blended Capital

As a philanthropic leader in 2007 Detroit, Kresge had few options. To some at the Foundation, choosing Detroit’s Woodward Corridor to mobilize commercial capital was almost a fait accompli due to the crippling effects of the 2008 global recession, the risk of doing nothing, and the lack of viable alternatives. Laura Trudeau, managing director of the Detroit Program at the time, put it very simply: “Well, we began with the corridor, because the conditions of the rest of the city were in free fall. We lost 240,000 people in the decade between 2000 and 2010. And the majority of those people left in the last four years...the need was to invest in one place that could visibly come back,” and Woodward Avenue was that place.

Many, including CEO and president Rip Rapson, would describe Woodward Avenue as the “backbone” of Detroit—a title it has earned in more ways than one. As illustrated in Figure 19, it is the region’s main artery that stretches 27 miles north through the heart of the city, from the Detroit River all the way up to Oakland County, passing major institutions and landmarks like Wayne State University, Tech Town, Detroit Medical Center, Detroit Institute of Arts, and The Spirit of Detroit. Woodward Avenue has been a local cultural and historical backbone for more than 200 years. Even its creation was a symbol of Detroit’s resilience, having been built after a fire in 1805 destroyed all but one building in the city. In the 1950s, it was home to over 100 automobile companies, and in 1963, it was where Martin Luther King Jr. marched with 125,000 others and proclaimed, “Free at last, free at last.”¹¹⁰

Aside from its clear symbolic appeal, the diversity of both functioning and abandoned properties along Woodward Avenue—offices, homes, churches, night clubs, museums, and medical centers—meant that it presented diverse opportunities that might attract different forms of

Structuring a Blended Capital Deal: Leveraging Capital for Detroit's Woodward Corridor



capital. As Trudeau points out, this also meant that investments along the corridor could potentially have a “catalytic effect,” radiating outwards through the more difficult neighborhoods.

Figure 19. Woodward Avenue¹¹¹



For all of these reasons, Kresge saw the Woodward Corridor, and specifically its Midtown segment, as the right leverage point to spark Detroit's revival, although it would take years of groundwork before the WCIF would begin to take shape.

Laying the Groundwork: Forging Partnerships and Creating Momentum with Grants at the Base of the Capital Stack

One of Kresge's key lessons from the Woodward Corridor project was the critical importance of grant capital to set the stage and to stabilize risks before investment capital can enter the scene. In retrospect, reflecting on the WCIF, SIP managing director Kimberlee Cornett says, “That intervention would not have been possible had the grant funds not preceded it by several years, because the way that the grant funds were deployed, it softened out the ground just enough that we could put other capital in.”

Structuring a Blended Capital Deal: Leveraging Capital for Detroit's Woodward Corridor



Grants were initially released to garner public sector support for backstopping the freefall of the housing crisis. In 2008, the Detroit Program made a \$750,000 three-year grant to support Detroit's Office of Foreclosure Prevention and Response in its efforts to persuade banks to renegotiate loans.¹¹² However, the politics of the banks in town did not allow for this. Trudeau calls it "probably the biggest failure we had during my period leading the Detroit Program." Yet, even this failed experiment helped Kresge and the SIP team identify partners to avoid.

Grant capital was also successful at fixing a variety of problems that would be too small to absorb large investment capital. For instance, the Detroit team deployed grants to repair broken streetlights, put more police-cars on the street, provide support to neighborhood groups, introduce arts and cultural projects, and make building façade improvements. Financial investors can sometimes fail to recognize the big-picture value of such modest initiatives, but it was clear to Cornett that such efforts built capacity with local partners and made it possible for investment capital to achieve scale.¹¹³ Perhaps the power of grant capital was felt most strongly when it helped forge two critical preliminary partnerships—with Susan Mosey at Midtown Detroit, Inc. and with Robin Hacke at Living Cities.

Susan Mosey is sometimes referred to as the "Mayor of Midtown," because she was one of the first to see its tremendous potential.¹¹⁴ According to Trudeau, Mosey was "dedicated to getting it right, and she just carried it all on her own back." Around 2010, Kresge recognized a need to expand her organization's sphere of influence and filled that need [by deploying grants]. Rip Rapson says that this "essentially built up the capacity of Midtown Detroit Inc. from about two people, Sue and one other, to almost 20 over time, increasing exponentially the ability to identify pipeline and move pipeline."

Yet, as with any form of capital, there are limits to how far grants can go alone. According to Rapson, the next pivotal moment in the journey came in 2010 when Living Cities made Detroit one of the five cities in its Integration Initiative—a step that brought major lending partners to the table. The Integration Initiative was a multi-city initiative to create cross-sector, systems-level partnerships, and the initiative integrated blended capital deployment. Mosey and Trudeau worked hard to make a case for Detroit's inclusion, and their argument was centered around Midtown and Mosey's vision for it.

As Rapson put it, "The idea was that we would use the ability of Living Cities to combine grant capital from its dozen philanthropic partners and loan capital from its dozen lending institutions. It was powerful both as matter of sheer financial heft and as a matter of optics because you had Chase and Deutsche Bank and Morgan Stanley and Prudential and MetLife and everybody on the planet at the Living Cities table trying to figure out how to enter five cities and optimize this potentially catalytic blended capital stack. We were able to convince Living Cities that Detroit ought to be one of those places, even though most of our lenders did not work in Detroit."

The Integration Initiative ultimately brought \$2.75 million in grants, \$4 million in PRIs, and \$15 million in commercial debt into Midtown Detroit. Most importantly, it created the possibility of further collaboration with commercial investors. "The Living Cities experience was an essential milestone in the creation of the Woodward Corridor Fund," says Rapson.

Building the WCIF: The Power of Social Investments, Leverage, and CDFIs

After grantmaking efforts and the Living Cities practice created momentum, the next phase in the WCIF story was driven primarily by Kresge's SIP team and market-based solutions. In 2012,

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then-Detroit program officer Benjamin Kennedy circulated an email calling out over two dozen promising, diverse real estate projects around the Woodward Corridor that were deserving of additional capital and that promoted Kresge's vision for a revived, vibrant Midtown. These were projects that grant dollars could not address. "We needed a 'capital war chest' that would provide the critical missing pieces of financing," says Rapson.¹¹⁵

Kimberlee Cornett, SIP managing director and her team began to seriously explore this avenue, seeking community input from banks, Community Development Corporations (CDCs), and others who might be interested. A study presented to the Social Investment Committee by a real estate developer revealed a growing demand for multi-family, mixed-income housing in Midtown: "Midtown's adjacency to the unique urban environment of central Detroit produces a strong competitive position with all of the other submarkets in the metro. High occupancy rates and rising rents in surrounding areas such as Ann Arbor and Troy create spillover demand that is intensified by Midtown's growing appeal to young professionals and non-family households."¹¹⁶

They projected that by 2013, demand would most likely outstrip supply, but the steep devaluing in both commercial and residential properties after the housing crisis had created loan-to-value ratios that were too high for commercial banks to lend. As Kresge's social investment officer, Aaron Seybert, explains it, "The problem was that there was no market for multi-family mixed income rental projects in the Woodward Corridor, because the appraised values were so extraordinarily low due to the blight."

An essential step in reversing that situation was the creation by Kresge and other local foundations of the "Midtown Live/Work/Buy program". The foundations created incentives for the employees of the anchoring institutions along the avenue—Wayne State University, the Henry Ford Hospital System, and the Detroit Medical Center—to live in the surrounding neighborhoods (as well as to buy local products and services and to hire local residents). The institutions took full advantage of the program, and the demand for both home ownership and rental units began to climb. In the words of Detroit program co-director Kennedy, "The program contributed to the creation of a cluster of activities that enabled residents to feel a tangible sense of progress."

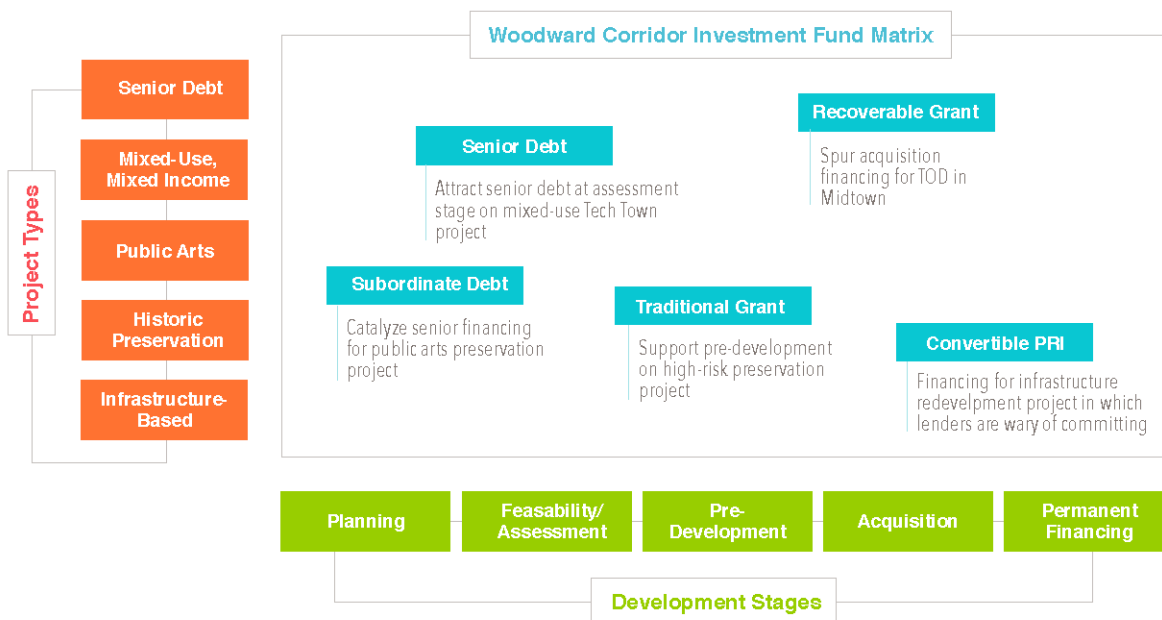
The WCIF built on this sense of progress, creating an instrument that could address the gap between the magnitude of the loans needed to bring a property to market and the underlying values of those properties—enabling construction lenders to lend with the possibility of commercial take-out. The result would be to make long-term, fixed-rate loans available for multi-family, mixed-use developments in Midtown.

One of the attributes of a philanthropic investor is its ability to take financial risks that a traditional lender cannot. If Kresge did not make the first move to invest, the chances of commercial lenders making their capital available were negligible, and as Figure 20 illustrates, Kresge needed to attract senior debt from commercial lenders if the objective of creating mixed-use, mixed-income projects was to be realized.

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Figure 20. WCIF Investment Matrix¹¹⁷



The SIP team built a careful strategy for the WCIF and its “capital war chest.” By putting forward \$5 million in subordinate debt, Kresge was able to pool \$15.25 million in senior debt from PNC Bank (\$5 million), MetLife (\$5 million), Prudential (\$5 million), and Max M. & Marjorie S. Fisher Foundation (\$250,000) and an additional \$10 million in subordinate debt from Calvert Foundation and Capital Impact Partners, the CDFI and fund manager.

A factor behind Calvert Foundation’s commitment was that Kresge committed an additional \$1.5 million in the form of a guarantee in favor of Calvert. The Kresge SIP team often incorporates guarantees into capital stacks, since they are a powerful tool for leverage. In the case of the WCIF, a promise to commit up to \$1.5 million under certain adverse conditions was enough to mobilize Calvert, on the strength of Kresge’s balance sheet, to put forward more than three times that amount.

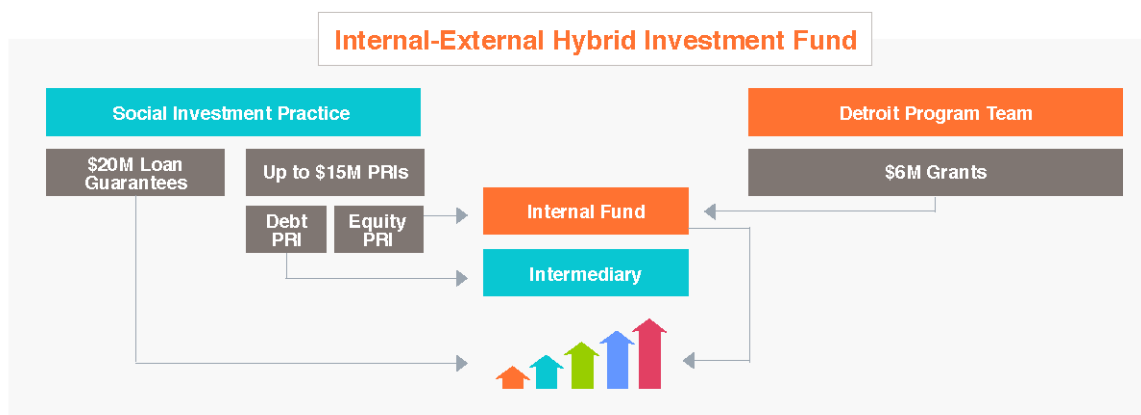
Another important aspect of the WCIF strategy was the role played by Community Development Financial Institutions or CDFIs. Once all the capital for WCIF was pooled, Kresge needed a partner to oversee the complexity of deploying it on the ground, and CDFIs were well positioned to do that. CDFIs are private financial institutions that are dedicated to providing affordable lending services for the benefit of low-income, disadvantaged communities. Rapson notes that prior to the Living Cities Integration Initiative, there were no CDFIs in Detroit. The Integration Initiative attracted Capital Impact Partners to Detroit for the first time and enabled the Detroit Investment Fund to transform into a CDFI, Invest Detroit. Kresge negotiated the outsourcing of the WCIF debt PRI (lending) side to Capital Impact Partners. As Figure 21 illustrates, WCIF was structured as an internal-external hybrid fund with Capital Impact Partners as the intermediary. Rapson explains how this allowed Kresge “to use the capacity of a strong intermediary (for lending purposes), while maintaining control of our most flexible capital tools (grants and

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guarantees) for strategic deployment alongside and/or in support of our externally managed debt capital.”

Figure 21. Hybrid Structure of the WCIF¹¹⁸



Impact, Intended and Unintended

Kresge’s experiences in the Woodward Corridor highlight some important lessons on building a blended capital deal—the critical role of grants in the capital stack, the importance of forging the right preliminary partnerships, the additional flexibility and perspectives brought by social investments, and the power of philanthropic capital to leverage commercial capital. The WCIF has moved multiple deals through the pipeline. It has also been cited as a major reason that JPMorgan Chase’s recently made a five-year commitment of \$100 million in loans and grants into Detroit. Aaron Seybert, social investment officer, who led JP Morgan’s operations in Detroit before coming to Kresge, remarks that when he was at the firm, they were involved in several WCIF projects, so when the \$100 million commitment was designed and JP Morgan was looking for Detroit investment models that had proven to work, “Woodward Corridor came way up on the list of something that is working amazingly well.”

At the same time, it is important to understand whether the fund has achieved its objective of promoting “density, diversity, vibrancy, and walkability in Detroit’s core” and what this means given Detroit’s volatile and complex racial history. Driving down Woodward Avenue today, the artery’s revival is palpable—it looks and feels like a Main Street that any American city would be proud to host. One of the fund’s success stories is Regis Houze—a \$4 million infill, rehab renovation of the St. Regis Hotel resulting in 58 apartments and retail space. According to Capital Impact Partners’ chief lending officer, Spote, the project has “improved the look and feel of the neighborhood.” These successes fill important market gaps and have helped bring more capital to the city. At the same time, many worry that the people on the street do not seem to reflect the income and race demographics of the city at large.¹¹⁹

This re-introduces the issue this case study previously examined: should Kresge have started to revive Detroit through its commercial core, or should it have headed for at-risk neighborhoods first? Rapson also notes that it raises the question “of whether these investments’ effect of setting in motion a fly-wheel of residential and commercial investment in the core can somehow be translated to the city’s neighborhoods.” As scholars Eric Seymour and Diana Flora observe,

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“The literature suggests that the benefits of such mega projects are often exaggerated and may even further existing inequalities. In the context of a shrinking city, development needs to be targeted to best serve existing residents, and not be pinned to the hopes of attracting an enormous influx of new residents.”

Tonya Allen, CEO of the Skillman Foundation, voiced to the *Christian Monitor* what many others feel. “It’s an important symbolic step for the progress of the city. But I also think it’s symbolic in the sense that it ends at Grand Boulevard,” she says. “It feels like it’s for the business core and for visitors, and not for Detroiters.”¹²⁰

Rapson notes, “I think it’s safe to say that the Kresge investments of capital into Midtown and the downtown were indeed catalytic...in the classic sense of injecting a foreign substance into a pre-existing condition and creating an entirely new set of reactions and realities. And it’s not just the Woodward Corridor Investment Fund. It’s also investments in the arts, in storefront improvements, in new public infrastructure, in a light rail project that provides the armature for a regional transportation system. All of these contribute to stabilizing the central arterial of the city, to building tax base, to signaling that we can successfully execute on complex projects, and to modeling the kind of capital tools that we’ll need to more fully take on the challenges of the neighborhoods.”

Rapson, like the Detroit team, agrees that the visibility of the revival along the Woodward Corridor has created some “unintended consequences,” leading certain community members to feel marginalized. But he also points out that the successes in the corridor should not be allowed to obscure the magnitude and the value of the simultaneous work Kresge was doing outside the corridor. He describes some of the concurrent work of the Foundation: “We played a pivotal role in creating a small business and entrepreneurial predominately focused on Detroiters and trying to re-diversify the Detroit economy. We created an arts and cultural program to ensure that the energy, the identity and the expressions of opportunity that were popping up in every neighborhood in the city were underwritten and supported. And perhaps most importantly, we spent four years engaging the residents and business of the city in creating a land use framework that would permit the long-term redevelopment of Detroit’s neighborhoods.”

Trudeau echoes Rapson’s views and points out the unique circumstances of Detroit: “We always wanted the whole city to come back. We were driven to act because of the need to grow the tax value of the city’s property for residents and also for city government. So we were cognizant of the need to have a city for everyone, but we were also very concerned about the low values preventing different types of investment. They actually prevented market rate borrowing, so every project that was done to try to rebuild the city needed deep, deep subsidy.”

Of course, as Kennedy points out, it is always easy to criticize strategy in hindsight: “I don’t think you can balance. You’ve got to pick what you want to work on and prioritize that at a given point in time. You can’t do everything for everyone all at once.” He says that when he arrived in 2009 “...people were writing this off, the Corridor...It was like, ‘You guys are crazy, it’s not going to happen.’ The work was a heavy lift and its success was far from certain.”

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Questions for Consideration

- To what extent are lessons from Detroit's revival applicable to other cities around the world, such as Mumbai, Shanghai, or Lagos? When trying to stabilize a city in urgent need of capital, how can funders ensure that they keep their actions tied to the high standards of the SDGs?
- To what degree is pre-investment social impact analysis important and possible while trying to save a city in freefall?
- Where and when can different forms of capital be most useful to stabilize a city?



Looking Ahead

Looking Ahead

Attacking Wicked Problems is a bold reach. It requires taking risks, asking big questions, and making mistakes. The Kresge Foundation stared into the challenge that was Detroit in 2008 and saw opportunity. And, like any innovative effort focused on a seemingly intractable problem, there were successes and setbacks, supporters and critics.

As with any new program, the choices made and opportunities not pursued—from the early planning stages through recalibration—have implications. However, when the problem is as complex as reimagining a major city and the reach is global, the repercussions of those decisions and neglected opportunities can be magnified. The case study highlights implications from various factors, including how the leadership moved forward boldly despite initial internal and external resistance and how the process evolved into a deep and ongoing conversation about what racial equity entails in this time and place.



The issues that the creation and implementation of Kresge's SIP have raised are not unique. Private foundations that deal with Wicked Problems (which is almost all of them) must challenge themselves to be more deliberate as leaders and to have the courage to tackle complexity while embracing diverse and often dissenting voices. These are not easy tasks or behaviors; they require ongoing intention and attention. They ask for more servants and fewer heroes, for more humility and less hubris, and for more curiosity and less knowing.

The head of the SIP program, Cornett, sums up where she believes the SIP is now: "Our portfolio is six or seven years old at the max. We didn't really have a strong enough theory going into it. A lesson for institutions going down this path is, 'How do you assess what success is?' Because boards, people who are like me and my staff, are naturally inclined to mitigate risk, and the truth is, we like it that way, because we want the money back."

Cornett offers the Woodward Corridor fund and the Healthy Future Fund work as evidence of impact. "There is real evidence of deeper change. A lot of our other deals, they're too young." She says that one issue facing these kinds of investment portfolios is that "...you wind up with a zoo full of exotic animals, all of whom eat something different and sleep at different times, and that's a big issue, because it makes risk management really hard. I can point to a number of deals in our portfolio that probably nobody else could ever do. Does that mean they were the wrong thing to do? Not necessarily, but some of them may have been the wrong thing to do."

Social investment officer Aaron Seybert offers another challenge: "Finding a way to bridge the divide between what we ... classically define as return. Financial return is always going to be embedded in this discussion, because we're generally speaking about stewardship of those resources."

Important to the future success of social investing at the Kresge Foundation is deep learning and commitment to candor, community, and equity—across the portfolio and in Detroit. Continued areas of learning for Kresge staff include learning from failure, improving the commitment to equitable outcomes and ways of working, a "who holds power?" discussion, and addressing the ongoing tension-filled question of where to focus limited philanthropic investment.

Fear of Failure

How foundations discuss what doesn't work is a critical part of improving any practice. The Kresge Foundation is experimenting with ways to have these conversations. "I think what we need to figure out is how we share failures more widely. We did actually recently sit around a table [with] a bunch of program officers, and the task was to talk about the last big grant that you did that was named unmitigated disaster," says Seybert. He recounts that program staff were willing to share among themselves but "not with their bosses, not with the board, not with directors."

Pain Point around Equity

According to Chera Reid, director of strategic learning, research and evaluation, the conversation about equity, and especially racial equity, remains an active one at the Foundation: "We are currently engaged in a big organization-wide change effort around becoming a more diverse, inclusive, and equitable organization, both in our internal practices



and externally. The frame the Foundation is using to bring what can be difficult conversation forward is “normalize, organize, operationalize.”

Reid looks at the uncomfortable moments caused by the racial equity conversation as signs of growth. “If you’re a little uncomfortable saying, ‘I’m not sure I’m on board with racial equity—equity seems like we’re inclusive,’ and I say, ‘No, we have to center racial equity, because look at our mission, and how could we not?’ then we’re tussling over it.” Her hope for the Kresge Foundation is that they continue to struggle. “I hope we will have a lot more of these awkward conversations, because this is the work of normalizing race in this organization,” she says.

Pain Point Around Power

Like many organizations, integrating SIP into the its longer standing program areas brought forward a central observation: Although the non-negotiability of the bulls-eye requirement has been clearly settled, there will always be outward pressure to undertake investments that lie at the edges. As Reid notes, “How much space you have around the bull’s-eye to make social investments is not likely to disappear as a tension.”

Tension between Midtown and Neighborhoods Focus

Kresge staff agree that Detroit was a broken system when they started SIP. Former Detroit managing director Laura Trudeau says in support of the focus on the downtown and Midtown, “We didn’t have enough hubris to think we were going to change Detroit. What we hoped is that we could help change the trajectory and the trend line, and so that’s really what we focused on for the last 10 years.”

Her successor, Wendy Lewis Jackson, agrees. “The narrative about the revitalization in the downtown and Midtown is so powerful, but I know philanthropic and municipal government are very focused on expanding the aperture and widening the sense of prosperity and opportunity beyond these 4.4 square miles.” Lewis Jackson feels that Kresge does get push back, starting with the question, “But did you bring along enough of the rest of the Detroit with you?”

Lewis Jackson sees the next challenge as identifying how Kresge and others can bring neighborhoods back online in Detroit with equity at the forefront while ensuring a complete, inclusive recovery. In particular, Jackson says dealing with opportunity and inequality are key challenges facing municipal leaders and philanthropic leaders.

Going Forward

In 2015, the Foundation identified approaches that need to evolve to reach its goal of using a full spectrum of capital tools:

- Allocate resources to reflect the intent to use both grants and a meaningful volume of social investments (both cash and non-cash funded) in funding strategies.
- Recognize that grants often are instrumental in making the use of other forms of capital possible.
- Expect staff—both Program and Social Investment—to take calculated risks.
- Pursue repayment as an important consideration.
- Align with key goals and objectives of the Foundation and its programs and leverage and replicate successful investments.



- Promote a continuous dialogue between program staff, staff in the Social Investment Practice, and Investment staff, about how market and financing barriers in a sector can impede progress against key programmatic goals.
- Develop investment initiatives that complement Program/Foundation strategies and consider opportunities to prioritize investments and managers that contribute to both the financial and social objectives of the Foundation, within the bounds of the Foundation's fiduciary duty.¹²¹

From the standing start in 2008 to the current day, the Foundation has made tremendous strides in embodying these ways of working into a successful social impact practice, and more remains to be done to better understand impact. The good news is that the use of a continuum of capital is now fully embedded into the structure of the Kresge Foundation.¹²²

Rapson said recently that social finance offers the possibility of presenting a different face of philanthropy to the new political decision-makers in Washington:

"It creates beneficial adjacencies between social purpose and private capital, and provides pathways for individuals to invest in proven models of successful innovation. It promises to link investment to tangible outcomes. Philanthropy has already done some of the difficult spadework by more closely drawing together markets and social benefit. Now we only need the verve to keep all our tools at the ready, work together, and leverage what we've learned in whatever uncertain times lie ahead."¹²³



Appendix 1. List of Interviewees

Name	Title	Organization
Aaron Seybert	SIP Social Investment Officer	The Kresge Foundation
Amy Robinson	VP, CFO, and Chief Administrative Officer	The Kresge Foundation
Ari Simon	VP of Programs and Chief Strategy Officer	The Kresge Foundation
Benjamin Kennedy	Managing Director, American Cities Practice	The Kresge Foundation
Bill Moses	Managing Director, Education	The Kresge Foundation
Chera Reid	Director of Strategic Learning, Research, and Evaluation	The Kresge Foundation
Clara Miller	President	The F.B. Heron Foundation
David Blaszkiewicz	President and CEO	Invest Detroit
David Fukuzawa	Managing Director, Health and Human Services	The Kresge Foundation
Debra Schwartz	Managing Director, Impact Investments	The John D. and Catherine T. MacArthur Foundation
Elaine Rosen	Board Chair	The Kresge Foundation
Fred Karnas	Senior Fellow	The Kresge Foundation
Jim Bildner	Trustee	The Kresge Foundation
Joe Evans	SIP Portfolio Manager	The Kresge Foundation
Kim Dempsey	Deputy Director, SIP, Kresge	The Kresge Foundation
Kim Rueben	Senior Fellow	Urban Institute

Appendices and Notes



Kimberlee Cornett	SIP Managing Director	The Kresge Foundation
Laura Trudeau	Consultant	Trudeau Consulting
Lois DeBacker	Managing Director, Environment	The Kresge Foundation
Marcus McGrew	Director, Program Operations and Information Management	The Kresge Foundation
Regina Smith	Managing Director, Arts and Culture	The Kresge Foundation
Rip Rapson	President and CEO	The Kresge Foundation
Robert Manilla	VP and Chief Investment Officer, Investment Office	The Kresge Foundation
Scott Spote	Chief Lending Officer	Capital Impact Partners
Sharon Zimmerman	Director of the Executive Office	The Kresge Foundation
Tracy Gordon	Senior Fellow	Urban Institute
Wendy Lewis Jackson	Managing Director, Detroit	The Kresge Foundation



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